Supreme Court of the United States,

No. 92—October Term, 1911.

LAWRENCE E. SEXTON, as Trustee in Bankruptcy, Etc.,
Appellant,

against

KESSLER & CO., Ltd., et al.,
Appellees.

BRIEF FOR APPELLEES.

McLAUGHLIN, RUSSELL, COE & SPRAGUE,
Solicitors for Appellees,
165 Broadway, Borough of Manhattan,
New York City.

ABRAM I. ELKUS,
FREDERICK C. McLAUGHLIN,
RUFUS W. SPRAGUE, Jr.,
Of Counsel.

WM. SIEGRIST, Law Printer, 146-148 Worth St., New York

Supreme Court of the United States.

LAWRENCE E. SEXTON, as Trustee in Bankruptcy of Alfred Kessler, Rudolf E. F. Flinsch and William K. Gillett, composing the firm of Kessler & Company, and the said Kessler & Company, Bankrupts, *Appellant*, *against* KESSLER & CO., Limited, and FRANK YOUATT, Liquidator, *Appellees*.	**October Term, 1911. No. 92.**

BRIEF FOR APPELLEES.

Statement of the Proceedings.

This is an appeal by the complainant-appellant Lawrence E. Sexton, as Trustee in Bankruptcy as aforesaid, from a decree in equity of the United States Circuit Court of Appeals, Second Circuit, entered June 9, 1909 (*R.*, *1145*), see *172 Fed. Rep.*, *535*, reversing a decree in equity of the United States District Court for the Southern District of New York, entered therein December 4, 1908 (*R.*, *1095*), and dismissing on the merits the bill of complaint herein brought in said District Court to set aside an alleged voidable preference.

Statement of Facts.

KESSLER & COMPANY, OF NEW YORK.

On January 1, 1902, the copartnership of Kessler & Company, of New York, was formed for five years, and consisted of Alfred Kessler, Rudolf E. F. Flinsch and William K. Gillett. The capital was $1,000,000, of which Mr. Flinsch contributed $400,-000, and Mr. Kessler and Mr. Gillett each $300,000. This copartnership had its office in New York City where it transacted the business of foreign bankers. On January 1, 1907, the partnership agreement was extended for one year, to December 31, 1907.

The copartnership bought and sold bonds, dealt largely in foreign exchange, issued letters of credit, promoted industrial and railroad enterprises and participated in syndicates (*Master's 1st Finding of Fact, R., 1002*).

The predecessor of this copartnership of Kessler & Co. was a copartnership also named Kessler & Company, of which Mr. Alfred Kessler, Mr. Flinsch and Mr. William Kessler (the father of Alfred Kessler) were members. Mr. William Kessler lived in Manchester, England, and was never in this country.

Mr. William Kessler died in January, 1901. Thereafter his interest in the former copartnership was liquidated and paid to his executors, except about $95,000, which was loaned to the new firm. The further sum of about $78,000 was loaned by the estate of William Kessler to Alfred Kessler; who in turn loaned a portion of it to Mr. Flinsch (*Master's 2nd Finding of Fact, R., 1004*).

For the first of these loans, the estate of William Kessler is an ordinary creditor of the bankrupt firm and for the second a creditor of Alfred Kessler individually.

Kessler & Co., Ltd., of Manchester.

In 1902, after William Kessler's death, the corporation of Kessler & Company, Ltd., Manchester, England, was organized, under the English Companies Acts.

It was managed by a board of directors, which consisted of Henry Kessler, Philip W. or P. William Kessler, George Kessler and George A. Averdieck. P. William and George were brothers of Alfred and sons of William Kessler. Henry Kessler was a second cousin of Alfred, P. William and George (*Master's 2nd Finding of Fact, R., 1003*).

The business of the Manchester corporation was manufacturing and dealing in dry goods which it sold all over the world through agents (*Master's 2nd Finding of Fact, R., 1003*).

This corporation succeeded a copartnership doing a like business in England, known as Kessler & Company, of which William Kessler had been a member (*Master's 2nd Finding of Fact, R. 1003*).

Upon his death, the corporation was organized, with a capital stock of £250,000, equally divided between ordinary and preference shares. £108,501 of ordinary shares were owned by the estate of William Kessler and other branches of the Kessler family, and by George A. Averdieck. Of £112,000 in preference shares issued, about one-half was owned by various members of the two branches of the Kessler family, and the balance by strangers. Alfred Kessler, of New York, owned £3,000 of ordinary and £3,000 of preference shares (*Master's 2nd Finding of Fact, R., 1004*).

Business relations between Manchester and New York concerns (*Master's 3rd Finding of Fact, R., 1004*).

Prior to 1903, the New York copartnership drew

what was known as "long drawings," that is to say, drafts payable in sixty or ninety days after sight, on the Manchester corporation, which were accepted on sight by the Manchester corporation. The amount of these drafts constantly outstanding was always about £80,000 (*R.*, *215*, *216*).

Other Similar Drawing Credits of New York Copartnership.

The New York copartnership had similar drawing credits, both secured and unsecured, with many other foreign houses (*R.*, *503-4*, *506-7-8*, *511-12*, *515*, *519*, *520*, *521*, *522*, *523-4*).

From January 1st, 1907, to October 30th, 1907, a period of ten months, it did a total business of about $161,000,000, of which approximately four-fifths was foreign exchange (*R.*, *652-3*). The margin of profit on such business is very small (about 1/32 of one per cent.) and consists of interest saved, and any decrease in the rate of exchange between the date of the draft and its maturity (*R.*, *620*, *625-6-7*). The drawing credit of £80,000, extended by the Manchester corporation, was neither large nor unusual. It had a larger drawing credit with Dreyfus & Co. of Paris, which was unsecured (*R.*, *522*).

Before the bills were accepted, they were sold by the New York copartnership to bankers and other persons in New York and the moneys received therefor went into the partnership funds of the New York copartnership and were used by them in their general business.

The New York copartnership undertook and agreed to provide for the payment of these drafts before maturity.

Agreement of June 30, 1903.

After the formation of the corporation of Kessler & Co., Ltd., the question of security for these

"long drawings" arose between the corporation and Kessler & Co., of New York. Kessler & Co., Ltd., asked for security and finally on February 17, 1903, wrote Kessler & Co. of New York as follows (*Defendant's Exhibit OO, R., 980; Opinion of* **Ward**, *J., R., 1133*).

"17 Feb. 3,

Private.

Messrs. Kessler & Co.,
New York,

Dear Sirs.—We beg to refer to the question of your providing security for the drawing credit which you have with us, which has already been privately touched upon. We understand from Mr. Edward Kessler that it would not be very convenient for you to provide this immediately and as wein no wise wish to incommode you, although from the altered circumstances of this firm it is a matter of some importance to us, *we propose to give you until the 30th of June of this year by which date the necessary securities should be set aside for us and a list sent us.* We do not propose to name a fixed amount of credit, suffice it to say that what you are at present using seems large, and rather than an increase we should like to see it somewhat reduced.

We trust that you may be able to give effect to our wishes even sooner than the date we stipulate for and we remain dear Sirs,

Y'rs, very truly,
P. W. Kessler."

The amount of drawing credit referred to in this letter was £80,000 or upwards (*R., 215, 216*).

After negotiations by the letter just set forth and otherwise, security was agreed on, and on June 30, 1903, the New York partnership sent the following letter to the Manchester corporation (*R., 938, 889,*

Master's 4th finding, R., 1005, Opinion of WARD, *J., R., 1133*).

"KESSLER & CO., BANKERS
No. 54 Wall Street,
New York.

Per S. S. 'Oceanic.' JUNE 30, 1903.

Messrs. KESSLER & Co., Limited,
Manchester.

Dear Sirs.—In accordance with instructions from Mr. Alfred Kessler, *we have today placed in a separate package in our safe deposit vaults the following securities, package marked 'Escrow for account of Kessler & Co., Limited, Manchester.'*

1484 shares Ocklahoma Gas & Electric Co., at 25	$37,100
2428 shares United Lighting & Heating Co., at 12	29,136
2352 shares Daimler Manufacturing Company, at 50	117,600
$373,000 United Breweries Co. first 6s, at 65	242,245
	$406,081

This escrow is intended as a protection against our long drawings against your good selves.

Kindly confirm if in order, and oblige,
Yours very truly,
KESSLER & CO."

On July 8, 1907, the Manchester corporation replied as follows (*R., 889; Master's 4th finding, R., 1006; Opinion of* WARD. *J., R., 1134*):

"8th JULY, 3.

Messrs. KESSLER & Co.,
New York.

Dear Sirs.—We are in receipt of your favor of 30th ultimo in which you advise us

of the securities you have laid aside as security for your long drawings on us. We have noted the particulars as given up to us and the matter goes in order.

If at any time you have the opportunity of realizing these securities or any part of them, you are at liberty to take them and to replace them by others of equal value, though in that case we should, of course, like to see rather better quality. * * *

We are, dear sirs,

Yours very truly,

P. W. KESSLER."

SUBSEQUENT CORRESPONDENCE.

On December 23, 1903, the Manchester corporation sent to the New York copartnership the following letter (*R., 890; Master's 4th finding, R., 100;; Opinion of* WARD, *J., R., 1134*):

"Private.

23rd DEC., 3.

Messrs. KESSLER & Co.,
New York.

Dear Sirs.—For the purposes of the audit of our books for our yearly balance sheet, we shall feel obliged if you would send us, in the form of a certificate, the particulars of the securities you have set aside against your drawing credit with us. We should like this done annually on the 31st December.

We do not think the matter will present any difficulty for you. Something in the form of the enclosed is what we require.

Thanking you in advance, we are, dear sirs,

Yrs. truly,

P.W. KESSLER.

(Enclosure.)

We certify that we have specially set aside and hold for your account on this the 31st day of December, 03, as security for the

drawing credit which you accord us, the following securities.
Name secs. and market value."

Thereafter, on January 1, 1904, the New York copartnership, conforming to these directions, sent the following certificate (*R., 891, and Master's 4th finding, R., 1007*):

"KESSLER & Co., 54 Wall Street,
Bankers. NEW YORK; 1 Jan., 1904.

Messrs. KESSLER & Co., Lim.,
Manchester.

Dear Sirs.—We certify that we have specially set aside and hold for your account on this the 31st day of December, 1903, as security for the drawing credit which you accord us the following securities:

1484 shares Oklahoma Gas & Electric............at	25	$37,100
2428 shares United Lighting & Heating.......at	10	24,280
2352 shares Daimler Mfg. Co..................at	50	117,600
$36,000 United Brewery New 1st 6% bonds......	100	36,000
$50,000 United Brewery New 1st 6% notes......	100	50,000
$134,800 Certificate of payments to Trust Co. on a.c. 1st Mortgage bonds of Chicago & Gt. Western R, R..................at	89	119,972
1348 shares Com. Stock C. Gt. W................	15	20,220
		$405,172
You hold in addition to this		
1606 shares United Lighting & Heating.........	10	16,060
		$421,232

KESSLER & Co."

On January 20, 1904, the Manchester corporation sent the following to New York (*R., 892, Master's 4th Finding, R., 1008*):

"Private 20 Jany 4

Messrs. KESSLER & Co.,
New York.

Dear Sirs.—We are in receipt of your favour of 1st Jan'y in which you give us particulars of the *securities you hold in escrow for us against your drawing credit* with us. The same are noted.

Should you, in the course of the year, through sale or otherwise, have occasion to vary this deposit, we should feel obliged by your advising us forthwith.

We are, dear sirs,
Yours very truly,
P. W. KESSLER."

The securities in this "escrow" were entered in the "Loan Book" of Kessler & Co., a regular book of account, in *red ink* (denoting money had been borrowed on them or they had been placed "in escrow" (*R. 312*), the first entry being under date of April 15, 1904 (*Exs. 6–12, R., 879–885*). These entries were headed in each instance "*Escrow Kessler & Co., Manchester.*"

Thereafter about the 1st of January of each year and in August, 1906, a certificate in the same form as above given was sent by the New York copartnership to the Manchester corporation, stating in detail the securities which were thus set aside (*R., 907, 922, 923, 929*) the receipt of which certificate was always duly acknowledged (*R., 909, ff*).

Defendants' Exhibit A (*R., 889–937*) is that portion of the correspondence between the New York copartnership and the Manchester corporation from June, 1903, to October 25, 1907, relating to the securities which were set aside, *and shows in detail*

the complete history of the so-called "escrows," and the substitutions which were always promptly reported by letter to the Manchester corporation. The original entries in the Loan Book also show what securities were set aside and the substitutions which were made. The lists on the outside of the envelopes in which the securities were contained or to which they were attached, likewise were original entries of the securities set aside, and substitutions were always noted on these lists at the time they were made.

SETTING ASIDE SECURITIES.

At the time that the letter of June 30, 1903, was written and sent, the New York copartnership took the securities therein mentioned, placed them in, or attached them to an envelope, and placed them on a separate upper shelf in a vault of the New York copartnership in a safe deposit company (*Master's 5th Finding, R., 1009*).

The securities which were set aside on June 30, 1903, were never removed from this safe deposit vault until October 25, 1907, except upon two occasions—once *in 1906*, when Mr. P. W. Kessler, a director of the Manchester corporation, was in New York, when the securities were taken over to the office and he checked them off (*R., 799*), and on a similar occasion in June, 1905 (*R., 914*), when Mr. Frank Youatt, the accountant of the Manchester corporation, was over here and for his examination the securities were produced and checked off by him (*Master's 5th Finding, R., 1009*). Mr. Youatt's letter (*Defendants' Exhibit A. R., 914*) shows that the securities checked up by him were all in order and correct according to the letters and certificates.

This envelope had written upon it "Escrow of Kessler & Co. of Manchester," and a detailed list

of the securities, with the values placed upon them (*Master's 5th Finding of Fact, R., 1009*), upon which list substitutions were noted at the time they were made, so that the list was at all times a correct detailed statement of the securities set aside, and corresponded exactly with the reports contained in the letters (*Exhibit A, R., 889–937*), with the entries in the Loan Book (*R., 879–885*) and with the certificates which were sent periodically.

The vault consisted of two parts, divided by a shelf. In the lower part was placed the leather box in which the securities in daily use by the New York copartnership were kept, and this box was taken to and from the safe deposit vault to the office every day (*R., 325, 836*)). Upon the upper shelf were placed, in separate packages, the securities belonging to customers and persons other than the copartnership (*R., 836*).

Whenever substitutions were made in the securities, a letter was immediately written by the New York copartnership to the Manchester corporation informing them what securities had been taken, or what moneys had been collected from the so-called escrow, and exactly what securities had been substituted in place thereof (*Exhibit A, R., 889–937, and Master's 6th Finding, R., 1009 and R., 1038*).

At all times there was an estimated margin of security over the amount of liability by reason of these long drafts (*Loan Book, Complainant's Exs. 6–12; R., 879–885*).

Entries in Books of New York Copartnership.

Among the regular books of account kept by the New York copartnership was a "Loan Book" (*R., 291*) above referred to.

The Master erroneously said this was a "memorandum book." Mr. Magee, the cashier of the New York copartnership, was the custodian of all

securities (*R., 303*), and the Loan Book was the book in which he entered all securities which had been deposited by the New York copartnership as collateral for loans.

In this Loan Book was entered, under the heading "Escrow of Kessler & Co., of Manchester," a detailed list of the securities which had been set aside in pursuance of the letter of June 30, 1903 (*R., 879, Master's 7th Finding, R., 1009*). The first detailed entry appears under date of April 15, 1904. As substitutions were made in the securities, the entry itself was altered by striking out the security taken away and interlining the security substituted and its value. These entries as to Kessler & Co., Ltd., were in *red* ink, which denoted that the partnership of Kessler & Co. had borrowed money on the securities or put them in escrow (*R., 312*).

When this had been done for some time and the entry had become overwritten because of these interlineations new entries on fresh pages were made, so that fresh entries of these securities were carried over under date of April 15, 1904, October 14, 1904, November 2, 1904, January 4, 1905, July 15, 1905, October 22, 1907 (*Complainant's Exs. 6-12; R., 879-885*).

The entry under the last date is set forth in the *Master's Report* (*7th Finding of Fact, R., 1010*).

£60,000 UNPAID AGAINST THE SECURITIES ABOVE MENTIONED AND £20,000 AGAINST THE "SPECIAL ESCROW."

The amount of long drafts drawn against these securities between June, 1903, and October, 1907, was always over £60,000 sterling (*R., 215, 216*), and on October 25, 1907, there were outstanding drafts by the New York copartnership, accepted by the Manchester corporation, secured by this first setting

aside of securities, amounting to £60,000 sterling and in addition £20,000 sterling accepted drafts against the "special escrow" herein later referred to (*R., 253*). A list of these outstanding drafts is given in *Complainant's Exhibit 73* (*R., 886*), and the drafts are in evidence (*Defendants' Exs. V, W, X, Y, Z, AA, BB, CC, DD, FF, HH, KK, LL; R., p. 945 to p. 977*). These drafts all matured on and after November 8, 1907, and owing to the failure of Kessler & Co. to perform their agreement by forwarding funds in advance of maturity to take up the drafts Kessler & Co., Ltd., went into a voluntary winding up under the English Companies Acts on November 11, 1907, Mr. Frank Youatt being chosen as Liquidator by the shareholders. The Manchester corporation had to pay and did pay all these drafts.

SPECIAL ESCROW OF £20,000.

On August 27, 1907, the New York copartnership wrote to the Manchester corporation a letter in part, as follows (*Master's 8th Finding, R., 1011*):

"KESSLER & Co.,
Bankers.

54 Wall Street,
NEW YORK, 27 Aug., 1907.

Messrs. KESSLER & Co., Lim.,
Manchester.

Dear Sirs.—A few days ago we sold at 90 1/2 and int. $20,000 Muskogee Gas & El. Bonds and withdrew them from your escrow replacing them by $20,000 Orleans County Quarry Bonds 1st 6%'s at 90.

We cabled you to-day we had drawn £20,000 60 d.s. on your goodselves and have placed in a separate escrow against this the following:

$25,000 Orleans Co. Quarry 1st 6s at 90	$22,500
Note $10,000 Orleans Co. Quarry secured by bonds at 75 Nov. 7...	10,000
Note $10,000 Orleans Co. Quarry secured by bonds at 75 Nov. 7...	10,000
Note $4,775 Orleans Co. Quarry secured by bonds at 75 Nov. 7 ...	4,775
Note $8,000 R. B. Maclea Co. Due Dec. 5	8,000
Note $7,000 R. B. Maclea Co. Due Dec. 5	7,000
Note $5,000 R. B. Maclea Co. Due Dec. 5	5,000
Note $16,000 Milne, Turnbull & Co., Nov. 11	16,000
Note $17.000 Milne, Turnbull & Co., Dec. 27	17,000
Note $7,000 Milne, Turnbull & Co., Dec. 27	7,000
	$107,275

Yours truly,

KESSLER & CO."

The Manchester corporation replied as follows (*Master's 8th finding, R., 1012*):

" Private.

4th SEPT. 7.

Messrs. KESSLER & CO.,
New York.

Dear Sirs.—We note from your favor of the 27th ulto. the change you have made in our escrow.

We also take note of the securities which you have lodged in a separate escrow against your special drawing of £20,000 about which you cabled us and which you advise in your ordinary correspondence received to-day.

We anticipate that this special drawing will not be renewed and that your drafts on us generally will presently come to a more moderate level.

Very truly yours,

P. W. KESSLER."

The securities were placed in a separate envelope endorsed "Special Escrow, Kessler & Co. of Manchester" marked with a detailed list of securities contained therein and placed on the same shelf in the same vault. Substitutions in this escrow were similarly made and reported (*Master's 8th Finding, R., 1013*).

An entry was made at page 154 (*Complainant's Ex. 12; R., 885*) of the same Loan Book "Special Escrow, Kessler & Co., August 27, 1907, £20,000, 60 days' sight," giving a detailed list of the securities set aside, and any change or substitution in the securities was carefully noted in the same book in the same way down to and including October 10, 1907 (*Master's 8th Finding, R., 1014*)

Four drafts of £5,000 each were drawn on August 27, 1907, by the New York copartnership against the Manchester corporation against this special escrow of £20,000 (*Defendants' Exs. V, W, X. Y; R., 945-948*). These drafts were sold to J. & P. Coats, Ltd., of Newark, N. J., for $97,550, the money was received by the copartnership and placed in the copartnership funds, and the drafts were accepted on September 7, 1907, by the Manchester corporation (*Master's 25th Finding, R., 1037*). The New York copartnership suspended payment under general assignment filed by Alfred Kessler before any of said drafts matured, and the Manchester corporation has been called upon to pay and has paid all of said drafts.

Nature and Condition of the Securities in the "Escrows."

The securities in these "escrows" are minutely detailed in the *Defendants' Exhibit QQ.* (*R, 980 to 997*). They were bonds, certificates of stock, promissory notes, a certificate of participation in a syn-

dicate of the Western Pacific Railroad Company bonds, and a deed in blank of and an assignment of mortgage in blank on certain real estate, 1018, 1020 and 1022 Bedford avenue, Brooklyn, New York. All the bonds were bearer bonds, none were registered. The stock certificates were made out either in the name of Kessler & Company or its individual partners or its employees and *in each instance* were duly endorsed in blank with a power of attorney to transfer in blank signed by the persons in whose name the certificate was made out, and duly witnessed. In almost every instance these endorsements and powers to transfer were dated, and the dates cover various times from 1901 to the early part of 1907, except the Elkton Mining stock. The deed of and the assignment of mortgage on the Brooklyn realty were dated and acknowledged November, 1905, and February, 1903, respectively. The promissory notes were as follows: three notes of Milne, Turnbull & Company, one dated July 11, 1907, and two dated August 27, 1907, and one note of R. B. Maclea & Company dated August 5, 1907, each of which notes was payable to the order of Kessler & Company and duly endorsed in blank by Kessler & Company; and four notes of the United Breweries Company dated September 17, 1903, payable to the order of the United Breweries Company and each duly endorsed in blank by the payee. The due dates of all these notes were subsequent to October 25, 1907.

Manchester Corporation Takes Physical Possession of Securities.

On October 25, 1907, Henry Kessler, who was in this country, after being advised so to do by counsel, at a time when, appellees contend, neither

Henry Kessler nor counsel knew or had any reasonable cause to believe Kessler & Co., the New York partnership, was insolvent, if such was then the fact, went to Alfred Kessler and said he wanted to take the securities in the two "escrows." Alfred Kessler replied: "*All right. They are yours. Do what you like*" (*R., 125-6, 252, Master's 9th Finding of Fact, R., 1015*). Thereupon Henry Kessler went to the vault with an employee of the New York partnership, removed the separate "escrow" packages of securities, hired a new vault in the name of the Manchester corporation, and placed the securities therein. He executed instruments by which he authorized certain clerks of the New York copartnership, as the agents of the Manchester corporation, to make future substitutions from time to time as required in the securities (*R., 1016, 1018*), which is hardly consistent with a belief by him that the New York corporation was then insolvent. Later, after a general assignment had been made in the name of the New York copartnership he revoked the appointment of these clerks and designated in their place Mr. Bacon and Mr. Kissell, bankers, took the securities to the Hanover Safe Deposit Company in New York, and placed them in a box rented by Kessler & Co., Ltd., where they have remained ever since.

On October 25, 1097, the New York copartnership informed the Manchester corporation by letter of the actual delivery to Henry Kessler, director, of the securities in the so-called escrows (*Master's 11th Finding of Fact, R., 1020, R., 936*).

On October 25, 1907, a draft for £5,000 (Ex. DD), dated October 15, 1907, drawn by the New York partnership on the Manchester corporation, was accepted by the Manchester corporation (Master's 12th Finding of Fact, R., 1022).

This last mentioned draft is owned by the Colonial Bank, which, it is admitted, is a creditor of

Kessler & Co., Limited, of Manchester, England, in voluntary liquidation, and which has received payment from the liquidator of the Manchester corporation (*Master's 12th and 29th Findings of Fact, R., 1023, 1039*).

GENERAL ASSIGNMENT AND BANKRUPTCY OF KESSLER & COMPANY, OF NEW YORK.

On October 30, 1907, Alfred Kessler executed a general assignment under the laws of New York for benefit of creditors in the name of the New York copartnership, to a Mr. Williams (*Complainant's Ex., 55, R., 562; Master's 19th Finding, R., 1029*). This assignment was executed by Mr. Kessler only, although Mr. Gillette was in New York City. Mr. Flinsch was in Europe or on his way to America.

On November 8, 1907, a petition in bankruptcy was filed, *alleging the general assignment as the sole act of bankruptcy*, and Mr. Sexton was appointed receiver (*Master's 20th Finding, R., 1029*).

MR. FLINSCH'S VISIT TO EUROPE.

Mr. Flinsch, one of the partners of the New York firm, went to Europe in June, 1907. He went principally on account of his health (*R., 499*), but also visited various banking houses in Europe, with which his firm had been transacting business. He had considerable correspondence with his copartner, Mr. Alfred Kessler, with reference to the affairs of the firm. This correspondence (*Complainant's Exs., 14–37; R., 687 to 735; Exs., 49–51, 53, 54, 57, 59, 61, 63, 66; R., 757–761, 764, 765, 770, 772, 776, 778, 781*) tends to show that the drawing credit of the New York copartnership as to its foreign exchange business was somewhat reduced, that some difficulty was encountered in selling bills on Dreyfus

of Paris, and that the firm, like most other American banking houses at that time was feeling the effect of the conditions which preceded the panic in the fall of 1907, and had its particular worries which are set forth at great length in these letters. There is not the slightest intimation in any of them that the firm was insolvent or that its standing and credit in the financial world was under the slightest suspicion or by any one questioned.

Mr. Flinsch, while in Europe, saw Mr. P. William Kessler on two occasions—once in Frankfort, Germany (*R., 529, 530, 534*), and later at Manchester, England (*R., 539, 540*), and at the latter interview, on October 5th, 1907, told him of the difficulty which then existed in selling American bills in London, and asked the assistance of the Manchester corporation either by the sale of drafts to be drawn by the latter against securities to be furnished, or in obtaining a direct loan upon such securities.

Kessler & Co., Ltd.'s, Knowledge of New York Firm's Condition.

As a result of this last visit, P. W. Kessler evidently became apprehensive that the outstanding long drawings by the New York copartnership on the Manchester corporation might have to be met by the latter and on October 7, 1907, cabled to Henry Kessler that the position of Kessler & Company of New York was unsatisfactory and that he (P. W. Kessler) was not in favor of extending further credit than the £80,000 already given, and advised the selling of securities by Kessler & Company of New York (*R., 548*). In other words, he did not take kindly to the suggestion (*R., 542*) that his company should assume further responsibilities. He saw little prospect of negotiating any loan at

that time and could only advise the sale of securities in New York. The difficulty which Mr. Flinsch stated to Mr. P. W. Kessler was not in obtaining sufficient drawing credit; it was the dificulty in selling the bills on Dreyfus of Paris.

Mr. Flinsch did not return to this country until the first week in November, 1907, after the general assignment had been made. Gillette, the other copartner of the firm of Kessler & Company, of New York, had been in Europe during the summer of 1907, and he returned to this country in August, 1907, but did not pay any attention to business, claiming to be ill, and refusing to come to the office or to aid the firm in its affairs (*Master's 19th Finding, R., 1029*).

The copartnership *met all its obligations promptly until October 30, 1907* (*Master's 20th Finding, R., 1029*), and sold "all the exchange it needed" on October 28th and 29th, 1907, after the actual delivery of the securities. Its inability to sell exchange to meet its moderate obligations which would mature later that week occurred on the afternoon of October 29, 1907, and precipitated the general assignment. Mr. Henry Kessler wrote to Mr. P. William Kessler, of Manchester, on October 25, 1907, a letter graphically describing the panic on Wall street, and naturally apprehensive as to whether the New York partnership could continue to sell its drafts under such conditions.

The Insolvency of the New York Firm.

The Master found and the District Court confirmed his findings that money was difficult to borrow in the week of October 25, 1907, that there was no substantial change in the affairs of the firm from October 25th to November 8th, and other facts with reference to the financial condition of the New York firm, including the failure *on Nov-*

ember 13, 1907, of Milne, Turnbull & Company, a copartnership engaged in the dry-goods business which the New York firm was assisting in financing.

The Master has set forth in full in his report numerous letters passing between P. W. Kessler, one of the directors of the Manchester corporation, and his brother Alfred Kessler, in which the affairs of the New York firm are somewhat discussed.

During the entire period from June 30, 1903, to October 25, 1907, the New York firm had, before the drafts became due, either remitted the money to the Manchester house to meet them, or arranged for their payment (*Master's 26th Finding of Fact, R., 1037*).

The schedules of the firm of Kessler & Company (*Complainant's Ex. 74 A., R., 887, 888*), *showed* an excess of liabilities over assets of about $250-000 (*R., 1038*). The securities in the "escrows" were valued in the schedules at $495,000 (*R., 887*). One of the appraisers appointed in the bankruptcy proceeding valued these securities at $257,495 (*R., 864*), stating, however, that these valuations were based upon the failure of Kessler & Company, of New York (*R., 865, 866*), and many of the securities were participations in syndicates of which the New York firm were managers. The liabilities, secured, were $2,414,337.83; unsecured, $1,403-723.36 (*Twenty-eighth Finding of Fact, R. 1038*). Kessler & Co., Ltd., were scheduled as secured creditors, the security being the "escrow" securities, in the amount of $377,815.73 (*R., 887*). *The schedules of the individual partners were not placed in evidence.*

The 1,606 Shares of United Heating, Lighting & Power Company in Manchester.

The Master found (*R.*, *1064*) that 1,606 shares of United Heating, Lighting & Power Company stock, which were in the list as being held with the other securities, and which, in fact, had been actually turned over in January, 1904, to the Manchester concern (*R.*, *1036*, *1064*) were held as a valid pledge. 10,000 shares of Elkton Mining Company stock were, on October 25, 1907, in the hands of the brokers of the New York copartnership in Colorado. These shares arrived in New York after October 30, but before the petition in bankruptcy was filed, and were turned over with the other securities to the Manchester corporation (*R.*, *1036*).

Findings and Conclusions.

Neither the Master nor the District Court found fraud, actual or constructive, or questioned the good faith of the parties. The Circuit Court of Appeals emphasizes the absolute good faith and honest intention of both Kessler & Co. and Kessler & Co., Ltd., and finds against appellant's contention of actual or constructive fraud. *The agreement for security was concededly enforceable in equity, inter partes.* The Circuit Court of Appeals has rightly reversed the District Court's decree setting aside the transaction of October 25th, 1907, as a voidable preference.

Summary of Appellees' Points.

The points relied on by the appellees and set forth below are :

I.

Appellees' right to the securities under the contract was absolute as against the bankrupts and their creditors at all times since June 30, 1903.

II.

The subsequent intervention of bankruptcy could not defeat appellees' right to the securities.

III.

The bankrupts' general creditors had no property right in the securities and appellees' contract was enforceable as against creditors.

IV.

The Circuit Court of Appeals was right in reversing the decree of the District Court.

V.

The authorities relied on by appellant are not applicable.

VI.

There was no reasonable cause for appellees to believe that a preference was intended by the delivery of the securities on October 25, 1907.

VII.

The decree of the Circuit Court of Appeals should be affirmed.

POINTS.

I.

Appellees' right to the securities under the contract was absolute as against the bankrupts and their creditors at all times since June 30, 1903.

(*a*) THE CONTRACT TRANSFERRED THE GENERAL PROPERTY IN THE SECURITIES.

In other words it was a valid mortgage.

Appellant insists (1) that it was an agreement for a pledge and nothing else, and (2) because physical possession of the scrip was not retained by the Manchester house the agreement was void as against simple contract creditors.

We employ the word "scrip" throughout this brief as a convenient term, to denote the stock certificates, bonds, notes and other documents which were in the package.

The distinctions between a pledge and a mortgage of *goods and chattels* at common law are that (1) a mortgage is a *conveyance which transfers the general property*, while a pledge transfers only a special property by *delivery* of possession; (2) in the case of a mortgage which transfers the general property possession in the creditor is not essential, whereas possession in the creditor is of the very essence of a pledge; (3) a mortgagee's title becomes absolute upon default, while a pledgee can sell after default only upon notice to the pledgor.

Story on Bailments, 9th Ed., Sec. 287;
Parshall vs. *Eggert, 54 N. Y., 18;*
Buffalo German Ins. Co. vs. *Bank, 162 N. Y., 163, 170;*
Wilson vs. *Little, 2 N. Y., 443.*

The distinction between a mortgage and a pledge of *incorporeal personalty* is not so apparent, and indeed it was for some time doubted whether such intangible property could be the subject of a pledge. It is incapable of manual delivery and cannot be reduced to possession. It is now settled law in New York that the only substantial difference between a mortgage and a pledge of incorporeal personalty is in the contract. If the contract gives the debtor a legal right to redeem upon payment of the debt at any time before actual sale, although after default, it is a pledge. Otherwise it is a mortgage.

Wilson vs. *Little, 2 N Y., 443.*

Stock already pledged and in the possession of a pledgee can be again pledged, without delivery of the scrip, to a third person, for a new loan. In *First Nat. Bank* vs. *Bacon, 113 N. Y. App. Div., 612, 614,* which so holds, the Court says:

> "The scrip is not the stock itself, and as to property not capable of manual delivery a pledge may be created by a written transfer thereof (*Wilson* vs. *Little, 2 N. Y., 445*)."

A pledge of stock is therefore like a mortgage, a transfer of the stock, and there can be no manual delivery. Possession of the scrip is of no importance. Physical possession of goods and chattels is an indicia of ownership. The statutes of New York, following the common law, emphasize the distinction. They make a sale or assignment by way of security of goods and chattels, except mortgages, without change of possession, *presumptively* fraudulent as against creditors (*N. Y. Personal Property Law, Section 36, former Section 25*) and further declare unfiled mortgages of goods and chattels void *as against simple contract creditors* (*N. Y. Lien Law, Section 230, former Section 90*).

Neither of these statutes applies to incorporeal personalty or choses in action (*Niles* vs. *Mathusa, 162 N. Y., 546*; *Booth* vs. *Kehoe, 71 N. Y., 341*; *Young* vs. *Upson, 115 Fed. Rep., 192*; *National Bank* vs. *Chaskin, 28 App. Div., 311*, and cases cited). There is no requirement in our law such as is found in the Louisiana statute, that delivery of the scrip shall accompany a sale or transfer by way of security of property of this description or that a mortgage of it shall be filed.

In *Stackhouse* vs. *Holden, 66 App. Div., 423*, the Court, discussing an assignment of book accounts, said:

> "Aside from the provisions of the bankrupt law prohibiting preferences, and subject to the rules of law relative to transfers *of goods and chattels*, debtors may transfer and pledge their personal property to their creditors in any manner they see fit, and any attempt to apply fixed rules for the transaction of the business would interfere with this undoubted right."

Even in the case of goods and chattels, where the presumption of fraud is rebutted, there is not the slightest doubt under the New York decisions, that sales and transfers by way of security (other than mortgages) without change of possession (the possession remaining in the debtor) are valid as against creditors or even *bona fide* purchasers without notice.

Parshall vs. *Eggert, 54 N. Y., 18.*

Farmers' & Mechanics' Bank vs. *Logan, 74 N. Y., 568*, was a case where the plaintiff bank loaned the money for the purchase of wheat, making a draft on the borrower for the amount of the loan. The goods were shipped under bill of lading which stated shipment on account and order of the plaintiff with instructions to notify the borrower.

The wheat was delivered to the borrower upon his acceptance of the draft, under agreement that he was to hold it in trust, as security for the payment of the draft. The borrower sold the wheat to defendants, who were innocent purchasers for value, without notice.

Judgment for plaintiff for value of the wheat was affirmed. The Court says:

> "Thus the case is kept out of the law governing the relations of pledgor and pledgee. The plaintiff was not a pledgee of the property of Brown. It had a right to it, not the qualified and special property of one holding, as a security, a chattel belonging to another. It had the legal title, under an agreement to transfer it on payment being made; it 'held the title in trust for Brown' after its own claim was satisfied (*Bank of Toledo* vs. *Shaw, 61 N. Y., 283*)."

The case of *Bank of Rochester* vs. *Jones, 4 N. Y., 497*, is here cited and followed.

See also

Moors vs. *Kidder et al., 106 N. Y., 32.*

Where merchandise is turned over by a bank to a merchant for purposes of sale, the bankers having advanced the purchase money and taken the bills of lading in their own name and the intention of the agreement being to preserve the banker's title to the goods, the lien of the banker is superior to the rights of third persons who have advanced money to the merchant upon a promise by the latter to pay them out of the proceeds, notwithstanding the fact that *possession* with all the indicia of ownership and full power of disposition by sale was at all times in the borrower.

Munroe vs. *Bonanno, Abbott's New Cases, XXXI, p. 1.*

Carter vs. *Arguinbau, Abbott's New Cases, XXXI, 3 N. Y. Common Pleas.*

English Bank of Rio de Janeiro vs. *Parr, Abbott's New Cases, XXXI, page 7; and*

Dennistown vs. *Parr, Abbott's New Cases, XXXI, p. 21.*

In *Bank of Rochester* vs. *Jones, 4 N. Y., 497*, the plaintiff discounted Foster's draft on defendant to put him in funds to purchase 200 pounds of flour. Foster shipped the flour to defendant and delivered the freight receipt to plaintiff. Plaintiff pinned the freight receipt to the draft and sent both to defendant, requesting defendant to accept the draft and take the flour. Defendant took the flour and sold it, without accepting the draft, claiming the right to apply the proceeds against Foster's general indebtedness to him.

Plaintiff sued defendant in trover, *claiming legal title.*

Judgment for defendant reversed. Paige, *J.*, said:

> "*The true ground on which to sustain this transfer of property to the bank is by regarding the transaction as a sale to the bank in trust; to deliver the property to Jones, in case he accepted the draft; and if he refused to accept the draft, then to sell the flour and retain out of the proceeds the amount of the draft, and to pay the surplus to Foster.* The transaction between Foster and the bank may also, I think, be regarded as either a pledge or a mortgage of the flour."

In *National Bank of Deposit* vs. *Rogers, 166 N. Y., 380* (discussed later), the Court of Appeals reached the same conclusion in equity, although

no freight receipt was delivered and there was no such constructive delivery. In equity, as we shall show later, the *contract* takes the place of the bill of lading or assignment.

The New York cases leave no room for doubt on the proposition that valid security may be created *on all kinds* of personal property by agreement without change of possession and control, except (1) in the case of *goods and chattels* where the presumption of fraud is not rebutted, and (2) an unfiled mortgage of *goods and chattels* is void by statute against general creditors. The rule is so stated in *Parshall* vs. *Eggert, 54 N. Y., 18.*

In our case we contend that the facts are strong enough to support a finding that the general property, that is the *legal* title, actually passed to the Manchester house on June 30, 1903, by the mutual assent of the parties evidenced by the consummated acts of the parties constituting the transfer.

Benjamin on Sales, 7th Ed., Section 3, reads :

> " By the common law, all that was required to give validity to a sale of personal property, whatever may have been the amount or value, was the mutual assent of the parties to the contract."

Of course the act constituting the transfer must be consummated, and not remain incomplete or rest in mere intention.

Martin vs. *Funk, 75 N. Y., 134, 137.*

The act constituting the transfer was here consummated when the securities were endorsed, done up in a package, marked with the name of the Manchester house as its property, set aside apart from the bankrupt's own property in the place where the property of other people was kept, entered upon the books of the bankrupt as property of the

Manchester house and a letter written by the transferor, declaring the transfer, signed and sent to the transferee.

Positively the only power over these securities left to the debtor was to remove particular securities for purpose of sale, provided other securities of equal value were substituted.

In full reliance upon this consummated transfer of title and upon the faith of it the Manchester house extended to the bankrupt a credit of £80,000. It is against good conscience to deny to this contract and what was done under it the full force and effect clearly intended by the parties. *A bill of sale could not have made that intention any clearer.* The contract of June 30, 1903, is a perfectly intelligible agreement between two business houses. It is not ambiguous. Both parties clearly understood an assignment of this property to the Manchester house in trust for the purposes of this security.

Thereafter not one act inconsistent with the ownership of the property by the Manchester house was committed. By the letter of July 8, 1903, (*R.*, *889*) for obvious reasons of necessity and convenience, the New York house was created agent of the Manchester house to sell any of the securities from time to time at a fair price, and to replace them with others of equal value. The hope was expressed that the quality of the "escrow" might be gradually improved by these operations. *This authorization of July 8, 1903, was in itself an act of ownership.*

The parties themselves always regarded the Manchester house as owner of the securities. The New York firm invariably wrote to defendant in regard to the escrow as "your escrow." On the first of every year and in August, 1906, they rendered to the Manchester house a formal certificate

of the securities "set aside and held for your account," as security for the long drawings. The securities were regularly entered in the books of the New York firm as having been deposited as security for loans. Mr. P. W. Kessler of Manchester, in November, 1906, stated to Mr. Flinsch and Mr. Alfred Kessler that he had checked off "our" securities (*R., p. 799*). When Mr. Henry Kessler went to Mr. Alfred Kessler on October 25, 1907, and told him he had been advised to take the securities, the latter replied: "They are yours, do what you like with them" (*R., pp. 125, 1015*). They were immediately surrendered by the New York firm upon request. On two previous occasions when representatives of the Manchester house were in this country they were surrendered to them for inspection and carefully checked off and a report made to the Manchester house.

The Manchester house accepted drafts to the amount of about £80,000 upon the faith of this written contract pursuant to which the securities were endorsed, actually delivered in 1905 and 1906, set aside and held as its property. Under the New York decisions the Manchester house held the legal title to the securities under a sale in trust, to deliver them to the bankrupts if the drafts were paid by the latter, otherwise to sell the securities and retain from the proceeds the amount of the drafts and to pay the surplus, if any, to the bankrupts. *Bank of Rochester* vs. *Jones, supra; Farmers' & Mechanics' Bank* vs. *Logan, supra: Moors* vs. *Kidder, supra; Munro* vs. *Bonnanno, supra; Carter* vs *Arguinbau, supra; English Bank of Rio de Janeiro* vs. *Parr, supra; Dennistown* vs. *Parr, supra; Parshall* vs. *Eggert, supra.*

In *Farmers' & Mechanics' Bank* vs. *Logan, supra*, the bank loaned the money to buy the wheat, took a bill of lading of it, but afterwards

surrendered the bill of lading and the wheat to the debtor, under an agreement that the wheat was pledged as security for the advances. In our case, the Manchester house accepted the drafts, after the securities had been endorsed, delivered, and set aside as its property, under an agreement that they should be security against the long drawings. In all the foregoing New York cases the property was *goods and chattels*, and the physical control was surrendered by the creditor. *Parshall* vs. *Eggert*, *supra*, clearly states the rule as to this kind of property.

There can be no doubt, under these decisions, but that the general property in the escrow passed to the Manchester house.

Inasmuch as our securities were properly indorsed for delivery we had no occasion to resort to a court of equity even prior to October 25, 1907, when we took possession of the scrip, to cure any defect in our title.

(*b*) THE CONTRACT WAS AT ALL TIMES ENFORCEABLE IN EQUITY AGAINST THE SPECIFIC PROPERTY SET ASIDE.

Whether the transaction was a declaration of trust, as Judge WARD said in the opinion of the Circuit Court of Appeals below, or an agreement for a mortgage or an agreement for security, is to our mind unimportant.

Judge NOYES, in his concurring opinion holds that the transaction could not be a declaration of trust because the New York house "intended to set aside the obligations only as *security* for their indebtedness to the Manchester house" (*see Opinions of Judges* WARD *and* NOYES, *R.*, *1133*, *1138*).

In *National Bank of Deposit* vs. *Rogers*, *166 N. Y.*, *380*, Judge LANDON said:

"Thus, when S. & Co. obtained posses-

> sion of the goods, plaintiff held their contract which characterized their possession *as in trust for plaintiff's security*, and equity requires that such characterization shall be taken as true, to the end that the security both parties agreed upon and intended shall not fail" (see also *Barry* vs. *Lambert*, *98 N. Y.*, *300*, and cases cited).

Judge WARD has, therefore, correctly stated the New York law.

We prefer, however, to rest our argument under this heading, upon the broader ground that there was a present agreement for security upon specified property. Or, as Judge NOYES puts it, "a pre-existing right well founded in equity." A court of equity will construe and enforce the contract according to the intent of the parties, if it is such a contract as can be equitably enforced by a decree *in personam*. In equity, therefore, it is immaterial whether the general property passed or not. The only question is whether it is such a contract as can be enforced by decree in equity.

The wording of the agreement was:

> "We certify that we have specially set aside and hold for your account on this 31st day of December, 1903, as security for the drawing credit which you accord us, the following securities" (here follows an itemized list).

The meaning of the word "escrow."

On June 30, 1903, the New York firm wrote:

> "We have placed in a separate package * * * the following securities, package marked '*Escrow* for account of Kessler & Co., Limited, Manchester.' * * * This *escrow* is intended as a protection against our long drawings against your good selves."

To which the Manchester corporation replied:

> "We are in receipt of your favor of the 30th ultimo in which you advise us of *the securities which you have laid aside as security for your long drawings on us.*"

Thereafter, the parties in their letters refer to "the securities you hold in escrow for us against your drawing credit with us" or to the securities that "we have specially set aside and hold for your account. * * * as security for the drawing credit which you accord us," and like expressions, leaving no doubt whatever what the parties meant by the use of the word "escrow." In the words of Judge LANDON, quoted above from *National Bank of Deposit vs. Rogers, supra*, they meant a "contract which characterized their (the New York firm's) possession as in trust for plaintiff's (Manchester corporation's) security."

A present agreement for security.

They both intended *a present agreement for security upon specified property.*

The right is usually given the debtor, in agreements of this character, to change the contents of the package, by proper substitution. When the nature of the property is considered, the absolute necessity of such an arrangement for the protection of both parties, is apparent. Sometimes, as in many of the cases previously cited, it is necessary to sell the property in the regular course of business, and apply the proceeds to the payment of the debt, and the debtor is given this power. There is no requirement that the property must remain intact, or within the physical control of the creditor. It must, however, be appropriated by the agreement to the purposes of the security, and at all

times be capable of identification so that a court of equity can decree specific performance.

Like the agreement in *Mitchell* vs. *Winslow, 2 Story, 630*, and in *Holroyd* vs. *Marshall, 10 House of Lords Cases, 191*, this agreement related to all the securities then placed in the package and to all which might thereafter be placed in the package by way of substitution or renewal.

The subject-matter of this suit is the property which was properly in that package on October 25, 1907, under the terms of the agreement.

In *Holroyd* vs. *Marshall*, which is, perhaps, the leading case on the doctrine of equitable assignment, the written contract contained this clause:

> "That all machinery * * * which, during the continuance of this security, shall be fixed or placed in or about the said mill * * * *in addition to or substitution for* the said premises, or any part thereof, shall * * * be subject to the trusts * * * hereinbefore declared and expressed concerning the said premises."

The debtor remained in possession and sold and exchanged some of the old machinery and introduced some new machinery. No conveyance was made of this new machinery, and the creditor never took possession of it until after an execution was levied.

Held, that the title under the bill of sale was to be preferred to that of the judgment creditor.

The Lord Chancellor (Lord WESTBURY) said in part:

> "My Lords, the question is, whether as to the machinery added and substituted since the date of the mortgage, the title of the mortgagees or that of the judgment creditor ought to prevail. * * * It is also admitted that if the mortgagees had an equit-

able estate in the added machinery, the same could not be taken in execution by the judgment creditor.

The question may be easily decided by the application of a few elementary principles long settled in Courts of Equity. In Equity it is not necessary for the alienation of property that there should be a formal deed of conveyance. A contract for valuable consideration, by which it is agreed to make a present transfer of property, passes at once the beneficial interest, provided the contract is one of which a Court of Equity will decree specific performance. In the language of Lord Hardwicke, *the vendor becomes a trustee for the vendee;* subject, of course, to the contract being one to be specifically performed. And this is true, not only of contracts relating to real estate but also of contracts relating to personal property, *provided that the latter are such as a Court of Equity would direct to be specifically performed.*"

Holroyd vs. *Marshall, supra*, was followed in *McCaffrey* vs. *Woodin, 65 N. Y., 459; Central Trust Co.* vs. *West India Co., 169 N. Y., 314.*

Cases like *Rochester Distilling Co.* vs. *Rasey, 142 N. Y., 570*, are not *contra*, because they are actions at law where plaintiff's claim rests upon legal title. In *National Bank of Deposit* vs. *Rogers, 166 N. Y., 380*, the plaintiff first brought his action at law, and his complaint was dismissed because clearly the legal title followed the bill of lading and was in defendant. Later the complaint was amended, alleging equitable title, and recovery was sustained by the Court of Appeals.

Mitchell vs. *Winslow, supra*, was a summary proceeding in equity by an assignee in bankruptcy (under the Act of 1843) for the possession of the property.

The bankrupts (cutlery manufacturers) had exe-

cuted a mortgage on their machinery, tools and implements, which contained a clause covering all that might be purchased within four years from date, and also all the stock manufactured and purchased during those four years.

Just before bankruptcy the mortgagee took possession of the property and sold it. The question related to the after-acquired property.

In holding that the mortgage of after-acquired property was good against the assignee, Judge STORY said, in part :

Page 644 :

> "It seems to me a clear result of all the authorities that wherever the parties, by their contract, intended to create a positive lien or charge, either upon real or upon personal property, whether then owned by the assignor or contractor, or not ; or if personal property, whether it is then *in esse* or not, it attaches in equity as a lien or charge upon the particular property, as soon as the assignor or contractor acquires a title thereto, against the latter, and all persons asserting a claim thereto, under him, either voluntarily or with notice, or in bankruptcy."

Pomeroy's definition of an equitable lien is as follows (*Equity Jurisprudence, 3rd Ed., § 1235*) :

> "The doctrine may be stated in its most general form that every express executory agreement in writing, *whereby the contracting party sufficiently indicates an intention to make some particular property*, real or personal, or fund, *therein described or identified, a security for a debt or other obligation*, or whereby the party promises to convey or assign or transfer the property as security, *creates an equitable lien upon the property so indicated*, which is enforceable against the property in the hands not

> only of the original contractor but of his heirs, administrators, executors, voluntary assignees and purchasers or encumbrancers with notice * * * The ultimate grounds and motives of this doctrine are explained in the preceding section ; but the doctrine itself is clearly an application of the maxim, *equity regards as done that which ought to be done.*"

This definition is expressly adopted as the law in *Ingersoll* vs. *Coram, 211 U. S., 335, 368; Walker* vs. *Brown, 165 U. S., 654 ; Howard* vs. *Delgado, 121 Fed. Rep., 26, 30 ; Goodnough Mercantile & Stock Co.* vs. *Galloway, 156 Fed. Rep., 504; Chattanooga Nat. Bank* vs. *Rome Iron Co., 102 Fed. Rep., 755 ;* and many other cases.

POMEROY (*Equity Jurisprudence, 3rd Ed*) says :

S. 1234. Origin and rationale of the doctrine :

> " If any reference to the theory of trusts is made, it is more acurate to describe these liens as analogous to trusts ; for while the two have some similar features, they are unlike in their essential elements.
>
> When equity has jurisdiction to enforce rights and obligations growing out of an executory contract, this equitable theory of remedies cannot be carried out, unless the notion is admitted that the contract creates some right or interest in or over specific property, which the decree of the Court can lay hold of, and by means of which equitable relief can be made efficient. The doctrine of 'equitable liens' supplies this necessary element ; *and it was introduced for the sole purpose of furnishing a ground for the specific remedies which equity confers,* operating upon particular identified property, instead of the general pecuniary recoveries granted by courts of law. It follows, therefore, that in a large class of executory contracts, express and implied, which the law

regards as creating no property right nor interest analogous to property, but only a mere personal right and obligation, equity recognizes, *in addition to the personal oblition*, a peculiar right *over* the thing concerning which the contract deals, which it calls a 'lien,' and which, though not property, is analogous to property (quoted by BRADLEY, *J.*, in *Elliott* vs. *Hovey, 118 New York, 124*) and by means of which the plaintiff is enabled to follow the identical thing, and to enforce the defendant's obligation by a remedy which operates directly upon that thing. The theory of equitable liens has its ultimate foundation, therefore, in contracts, express or implied, which either deal with or in some manner relate to specific property, such as a tract of land, particular chattels or securities, a certain fund, and the like."

Some of the many New York cases declaring and applying the doctrine of equitable lien are :

National Bank of Deposit vs. *Rogers, 166 N. Y., 380 ;*
Hamilton Trust Co. vs. *Clemes, 163 N. Y., 423 ;*
Hovey vs. *Elliott, 118 N. Y., 124 ;*
Coats vs. *Donnell, 94 N. Y., 168 ;*
Spring vs. *Short, 90 N. Y., 538 ;*
Husted vs. *Ingraham, 75 N. Y., 251 ;*
McCaffrey vs. *Woodin, 65 N. Y., 459;*
Parshall vs. *Eggert, 54 N. Y., 18 ;*
Bank of Rochester vs. *Jones, 4 N. Y., 497.*

Let us suppose now that there had been no bankruptcy of the New York copartnership, and that on October 25, 1907, the demand of appellee for physical possession of the scrip had been denied, and appellee had brought a suit in equity against the New York copartnership to enforce its lien upon

the securities under its contract. *There can be no doubt whatever, under the authorities, that appellee would have obtained a decree enforcing its lien.*

The property was sufficiently identified under the agreement, to enable a court of equity to specifically enforce it. It was all in a secure package, set aside in a vault, marked with appellee's name as its property, carefully listed on the outside, entered in the New York copartnership books as having been deposited to secure appellee's obligation under its acceptances, and upon the faith of the agreement appellee was then actually liable upon its acceptances of the New York copartnership drafts, to the amount of £30,000.

The District Court below, whose decree has been reversed, had no doubt on this point. The learned Judge in his opinion, said (*R., 1093, 1094*):

> "Now it may be assumed that such an agreement was and is valid in equity *inter partes.*"

Again (*R., 1093*):

> "It may be assumed, and I think correctly, that the original escrow agreements were good *inter partes.*"

If this agreement is valid in equity *inter partes*, then it creates an equitable lien. An equitable lien by express contract is nothing more than an agreement for security on property enforceable in equity *inter partes.*

Equity confers only "specific remedies" (*Pomeroy, § 1234, supra*). It cannot act unless the property is specified.

To say that this contract could not on October 25, 1907, have been specifically enforced in a suit in equity *inter partes*, is contrary to justice and com-

mon sense, and neither the Master nor the learned District Judge below has expressed such a view. The Master is silent on the subject, the District Court below, as we have seen, has expressed the opinion that the contract is enforceable in equity, *inter partes.* And there can be no doubt whatever that it is so enforceable

(c) PHYSICAL DELIVERY WAS NOT ESSENTIAL.

Physical delivery is impossible with property of this description.

Wilson vs. *Little, supra.*

Physical possession of certificates of stock is of no importance whatever in New York, except where a *bona fide* purchaser for value has arisen and then only where a case of estoppel by agency has been established.

Knox vs. *Eden Musee, 148 N. Y., 441;*
N. Y., N. H. & H. R. R. vs. *Schuyler, 17 N. Y., 592; 34 N. Y., 30;*
Moore vs. *Met. Bank, 55 N. Y., 41;*
Weaver vs. *Barden, 49 N. Y., 286.*

POMEROY says (*Eq. Juris, § 1233, supra*):

> "It is of the very essence of this condition that while the lien continues the possession of the thing remains with the debtor or the person who holds the proprietary interest subject to the encumbrance."

Judge STORY, in *Parker* vs. *Muggridge, 2 Story, 334,* says:

> "Possession is by no means necessary to create an equitable lien. On the contrary, in equity and admiralty, liens exist alto-

> gether independently of possession, as, for example, the lien of the vendor for the unpaid purchase money where he has conveyed the land; the lien of a bottomry holder, and the lien of a seaman on the ship for his wages."

See also

> *In re Nat. Cash Register Co.*, *174 Fed. Rep.*, *579*, *C. C. A.*, *3rd.*

(*d*) THE BANKRUPTCY RULE STATED AND CONSIDERED.

Innumerable cases are found in the books where the right to have agreements for security, or inchoate liens of some description, enforced against an assignee or trustee in bankruptcy, has been involved. The correct rule which explains and differentiates the cases is stated by *Lowell on Bankruptcy 3rd Ed.*, *page 66*, *§ 86*, as follows:

> "*Promise to give security.* In this country, *a promise to give security at some future, indefinite time, or when required, or a general covenant for further security,* will not authorize the debtor to give, and the creditor to receive security under circumstances which would make it a preference. In other words, the general and indefinite promise is disregarded.
>
> A *bona fide* engagement to convey specific property, amounting to an equitable lien will, however, be valid, and this is the test."

This Court has made the same distinction in the late case of *Page* vs. *Rogers*, *211 U. S.*, *575*, *579*; see also *Ingersoll* vs. *Coram*, *supra*.

The Master and the District Court below have misunderstood this rule and misapplied it. The

Circuit Court of Appeals applied it correctly in reversing the District Court.

Inasmuch as there is a difference of opinion in this case, as to what Lowell meant by a "general and indefinite promise" which "is disregarded," it is necessary to refer to the cases which he cited.

Arnold vs. *Maynard, 2 Story, R., 349, 358,* was a case of a "previous request or demand of the creditor, or the verbal promise of the debtor, when he contracted the debt, to give security *upon request.*"

Graham vs. *Stark, 3 Benedict, 520, 534,* was a case of a verbal promise by the debtor, long before the securities were given, "to give security *when required.*"

In *ex parte Ames, 1 Lowell, 561,* Judge LOWELL himself wrote the opinion. He says, at *page 564:*

> "And with us it is perhaps not the law, as it is in England, that a *general promise* of security given at the time the debt is contracted, may be executed after the debtor has become insolvent" (citing *Arnold* vs. *Maynard, supra, Graham* vs. *Stark, supra,* and *Blodgett* vs. *Hildreth, 11 Cush., 311*). * * *
>
> "I have not seen or known of any case which brings up the somewhat nicer question, argued here, *whether specific and definite security, unconditionally stipulated for in writing,* may be given after a lapse of time and a change of circumstances. *This may depend on whether the contract is one that a court of law or equity would enforce in invitum;* for I apprehend and have often decided subject to a correction that has not yet been made, that the assignee stands no better than the bankrupt in all matters of title, excepting where there is actual or constructive fraud."

Bank of Leavenworth vs. *Hunt, 11 Wall., 391,* was a case of an unfiled chattel mortgage where an

oral agreement was made by the debtor to deliver to the creditor an entire stock of goods covered by the mortgage, whenever the creditor should desire.

Brett vs. *Carter, 2 Lowell, 458,* and *Barron* vs. *Morris, 14 N. B. R., 371,* were both cases involving the question whether a clause in a chattel mortgage permitting the mortgagor to "sport with the property" made the mortgage void.

Unfiled chattel mortgages unaccompanied by change of possession, or permitting the debtor too "sport with the property" until default, may be and usually are inconsistent with any agreement for present security. There is nothing of the sort in our agreement.

In *Lloyd* vs. *Strowbridge, 16 N. B. R., 197,* the rule is stated as follows (*p. 200*):

> "Whatever may be the law in England, it is settled in this country that a general promise, made at the time the debt is contracted, to give security *if required*, cannot be executed after the debtor has become insolvent" (citing cases).

Burdick vs. *Jackson, 15 N. B. R., 318,* was a New York case. The opening language of the opinion by GILBERT, *J.*:

> "One of the first principles of equity is that it looks upon things agreed to be done, as actually performed. Acting upon this principle, courts of equity in England and in this country have held, that an agreement based upon a valuable consideration to give a mortgage will be considered in equity as a mortgage. That doctrine has been acted upon so frequently and for so long a period of time that it may justly be regarded as forming a part of the law of the land (citing numerous cases). * * *
>
> The plaintiff (assignee in bankruptcy) is not a *bona fide* purchaser, but stands in the

> shoes of the bankrupt. He cannot, therefore, assert any better right than the bankrupt himself."

Held, that a parol agreement for a mortgage on real estate between the bankrupt and respondent's guardian, supported by good consideration, would be treated in equity as a mortgage, and where the mortgage was executed in pursuance of this parol agreement, just before bankruptcy, it was not a preference, and is valid as against the assignee.

Holmes vs. *Winchester, 135 Mass., 299*, held that a promise by a husband given over two years before, in consideration of release of dower by his wife, to convey to her certain real estate some time in the future, was not sufficient to prevent the actual conveyance from being a preference. The Court says (*p. 303*):

> " An agreement to give future security is an executory contract and 'imposes no higher legal obligation upon the debtor than his promise of payment, involved in the contracting of the debt.' And his fulfillment of the one is equally open to objection as a preference as his fulfillment of the other (*Forbes* vs. *Howe, 102 Mass., 427, 435* ; *Ex parte Ames, 1 Lowell, 561*)."

In our case there was no promise for security " when required " or " upon request." It surely was not a " general promise " to give security some time in the future. It related to specific property then set aside and always capable of identification. Our case does not present the question " whether specific and definite security, unconditionally stipulated for in writing, may be given after a lapse of time and a change of circumstances " (*ex parte Ames, supra*).

In our case the security was actually given on

June 30, 1903, when the property was set aside and the letter sent.

As early as February 17, 1903 (*R.*, *980*) defendant served a notice in writing upon the New York copartnership which refers "to the question of your providing security for the drawing credit which you have with us, which has already been privately touched upon, and continues: "we propose to give you until the 30th of June of this year, by which date *the necessary securities should be set aside and a list sent us*."

On June 30, 1903, the thing was actually done, not promised (*R.*, *938*, *889*, *and Master's Fourth Finding*, *R.*, *1005*). The securities were set aside and the list was sent. The defendant on July 8th, 1903, acknowledges the receipt of the letter of June 30, 1903, as follows (*R.*, *889*):

> "We are in receipt of your favor of 30th ultimo, in which you advise us of the securities *you have laid aside as security for your long drawings on us.*"

No future act was contemplated to render this security effective. The securities were *immediately* endorsed, *immediately* set aside, *immediately* entered in the Loan book as hypothecated securities, and were then and always thereafter treated as the property of the Manchester house. The intent of the parties to give *present*, *bona fide* security for the drawing credit is unquestionable.

For four years and a half, in implicit reliance upon this contract, defendant extended the New York copartnership, a constant drawing credit varying from £60,000 to £120,000 (*R.*, *215-6*).

The permission given by defendant to the New York copartnership to take securities in the package, whenever they could be sold to advantage, and to replace them by others of equal value (*R.*,

889), surely did not make the contract a future one.

There was, therefore, nothing future about the promise, nothing indefinite or general, as to the time or subject matter. It was a present agreement for security on specified property, then and at all times subsequently identified. There was a complete and absolute appropriation of this property at all times to the purposes of the security.

In *National Bank of Deposit* vs. *Rogers* (*166 N. Y., 380*), S. & Co. borrowed $3,000 from plaintiff, giving a note which recited that they had deposited with plaintiff as collateral security certain merchandise, S. & Co. at the same time gave plaintiff a paper whereby they acknowledged receipt of the merchandise from plaintiff and agreed to hold the goods in trust for plaintiff, to give them the proceeds in case of sale, and authorized plaintiff to cancel the trust at any time and take possession of the goods or the proceeds. *The fact was, that the goods were never delivered to plaintiff.* They were in the Custom House. Plaintiff was shown bills of lading, which were immediately returned. *No freight receipt, bill of lading or other similar document was issued to plaintiff or surrendered to it.* S. & Co. took possession of the goods and subsequently assigned them to the defendant upon consideration of antecedent debts and as trustee to pay from the assigned property debts to himself and others. The Court of Appeals held, Landon, *J.*, writing:

> "Their (S. & Co.) title and possession were thus complete and their duty was thenceforth to hold the goods precisely as if they had first deposited them with the plaintiff and the plaintiff had delivered them back under the terms of the surety agreement. This is what both parties intended should be done, what the surety agreements were intended to cover,

the moment S. & Co. should obtain the goods. The parties treated that as done which ought to have been done, and might have been done, and as S. & Co. thereby obtained from the plaintiff $3,000, it is clear that equity and good conscience required them to treat it as done the moment the goods came into their hands, and continue so to treat it until the plaintiff should be reimbursed. * * * As between themselves it was competent to show what occurred, and equity will do just what the parties themselves did, namely, treat that as done which ought to have been done. Thus, when S. & Co. obtained possession of the goods, plaintiff held their contract which characterized their possession as in trust for plaintiff's security, and equity requires that such characterization shall be taken as true, to the end that the security both parties agreed upon and intended shall not fail. Effect can be given to the intention of the parties by holding S. & Co. strictly to the letter of their contract. *Nathaniel P. Rogers, their assignee, upon consideration of antecedent debts and as their trustee to pay from the assigned property debts to himself and to others, stood in their shoes and thus had no intervening equities against the plaintiff.*"

(*e*) POSSESSION TAKEN EVEN OF GOODS AND CHATTELS, UNDER A CONTRACT FOR SECURITY, RELATES BACK SO AS TO CUT OFF ALL EXCEPT CREDITORS WHO HAD INTERVENED BY EXECUTION OR ATTACHMENT AND BONA FIDE PURCHASERS.

The possession so taken gives a title or rights enforceable in a Court of Law.

In *Parshall* vs. *Eggert* (*54 N. Y., 18*), R borrowed money from plaintiff, giving a note to which was attached a receipt stating "Received in store for the account of P. & S. subject to their order,

the following named property, as security to my note (stating amount)." The note matured. Plaintiff never took possession of the property in defendant's store until after defendant had become insolvent and had absconded. He then went to R's store, showed the receipt and took the keys, locking the store. Later the same day a Sheriff broke open the door and levied on the goods by virtue of an attachment obtained by H, a general creditor.

In an action at law against the Sheriff *for conversion of the property*, the Commission of Appeals held that the receipt was *a declaration that R held the property as security for the notes* given to plaintiff. Had the property in question been delivered to the plaintiff, it would have created a valid pledge. The Court said :

> " I know of no authority denying the right of a party who has a contract for a pledge ineffectual for want of delivery, to obtain a delivery at a subsequent time, and thus to validate the pledge. Upon general principle, the only obstacle which can prevent such a transaction from being effectual must be the intervention of fraud. Certainly there is no rule of law which requires a pledge in writing to be filed as a chattel mortgage ; nor is it consonant with any rules for the construction of statutes to borrow such a requirement as to pledges from the positive provisions which, when enacted, were introductive of a new rule, and which declared unfiled chattel mortgages absolutely void as against creditors ; nor is there any warrant for saying that because a chattel mortgage unfiled could not afterward be filed with the effect to cut off the right of an intermediate creditor to avoid it as under the statute as conclusively fraudulent, therefore, a pledge of undelivered goods cannot be made effectual against an intermediate creditor by delivery, in the absence of fraud. Though a contract

of pledge should be regarded, when unaccompanied by delivery, as within the other provisions of the statutes in regard to fraudulent conveyances and contracts as to personal property, the question of fraud then arising would be a question of fact upon which the party would have a right to go to the jury. In the absence of any intermediate right, the parties could perfect a written contract or pledge by subsequent delivery. Even between successive pledgees, without any communication with each other, that one who lawfully obtains possession, at the time of the pledge or subsequently, is entitled to be preferred. * * * A creditor who acquires a specific right to or lien on the thing pledged may prevent the pledgee's interest in an undelivered chattel from attaching. But such is not the condition of the creditor at large. The only ground on which he can claim to prevent the perfecting of such a right in the pledgee is that it works a fraud upon him. The transaction is not one which any statute calls fraudulent in itself, and its validity ought, therefore, to go to a jury."

Parshall vs. *Eggert, supra,* was cited and approved in *Nat. Bank of Deposit* vs. *Rogers, supra.*

The same doctrine has been repeatedly declared by this Court.

> *Hausell* vs. *Harrison, 105 U. S., 401;*
> *Thompson* vs. *Fairbanks, 196 U. S., 516;*
> *Humphrey* vs. *Tatman, 198 U. S., 91.*

And by other courts

> *Godwin* vs. *Murchison Nat. Bank, 145 North C., 320;*
> *Fisher* vs. *Zollinger, 149 Fed. Rep., 54, C. C. A. 6th,* LURTON, *J.;*

Union Trust Co. vs. *Bulkley, 150 Fed. Rep., 510, C. C. A. 6th;*
Bank vs. *Penn. Trust Co., 124 Fed. Rep., 968, C. C. A. 3rd*

It is true that in some cases the possession taken just before bankruptcy has been held not to relate back, but these are cases where the original contract was either (1) fraudulent in law and hence void *as against general creditors* (*Zartman* vs. *Bank, 189 N. Y., 267, 273; Security Warehouse Co.* vs. *Hand, 206 U. S., 415*), or (2) made void *as against general creditors* by local statute (*Skilton* vs. *Codington, 185 N. Y., 80*), or (3) was a mere general and indefinite promise, under Lowell's definition (*Lowell on Bankruptcy, § 86, supra*), and hence insufficient to create an equitable or inchoate lien (*In re Great Western Mfg. Co., 152 Fed. Rep., 123; Ryttenberg* vs. *Schefer, 131 Fed. Rep., 313*).

It is absolutely clear that possession so taken under a contract for a pledge of goods and chattels would be good against the trustee in bankruptcy.

Parshall vs. *Eggert, supra.*
Humphrey vs. *Tatman, supra.*

In *Hauselt* vs. *Harrison, 105 U. S., 401,* the agreement was:

> " And it is further agreed that all the skins, whether green, in process of tanning, tanned, or tanned and finished, *shall be considered as security*, etc., for the advances."

The following language from Mr. Justice MATTHEWS in the last cited case is very applicable to our case :

> " It was decided in *Gregory* vs. *Morris* (*96 U. S., 619*) that the legal effect of such a contract is to create a charge upon the property, *not in the nature of a pledge but of a*

> *mortgage.* Such a lien is good between the parties, without a change of possession, even though void against subsequent purchasers in good faith without notice, and creditors levying executions or attachments; and if followed by delivery of possession, before the rights of third persons have intervened, it is good absolutely."

It was held, *in an action at law*, that possession taken under this agreement, immediately before bankruptcy and in contemplation thereof, was good against the assignee in bankruptcy.

In *Wood* vs. *U. S. Fid. & Guar. Co., 143 Fed. Rep., 424,* the contract between a building contractor and his surety contained this clause :

> " We do further agree in the event of our being unable to complete or carry on the aforesaid contract, to assign, and we do hereby assign, such plant as we may own or have upon said work, to the United States Fidelity & Guaranty Company."

Held, that possession taken under the agreement just prior to bankruptcy, was good against the trustee in bankruptcy.

It is clearly established by all of the authorities that where the contract is a present agreement for security on specified property, possession taken under it relates back to cut off all, except creditors who have intervened by execution or attachment and *bona fide* purchasers for value.

(*f*) AN EQUITABLE LIEN UNDER THE LAW OF NEW YORK IS ALWAYS PREFERRED OVER GENERAL CREDITORS, SUBSEQUENT JUDGMENT CREDITORS, MECHANICS' LIENORS AND EVERYONE EXCEPT PURCHASERS FOR VALUE.

Here again, to understand the cases, the distinc-

tion between an action at law and a suit in equity must be kept in mind.

In *Rochester Distilling Co.* vs. *Rasey*, *142 N. Y.*, *570*, GRAY, *J.*, said :

> "This action being one at law, the inquiry is limited to ascertaining the strictly legal rights of the two contending creditors to the property of their debtor, Powell, in the crops which he had raised."

In the above case the Sheriff had made a levy in execution and the action was a possessory action at common law and the rights of the parties were determined by the common law. At law there must be a "*novus actus interveniens*," referred to in Lord Bacon's famous maxim. In equity, the rule is more favorable to the equitable lienor. The title is good without the new intervening act, and the lien attaches the moment the property comes into existence (see Lord CHELMSFORD'S opinion in *Holroyd* vs. *Marshall*, *supra*; *McCaffrey* vs. *Woodin*, *supra*).

From the numerous New York cases which establish our proposition, we select only one quotation. In *American Sugar Refining Co.* vs. *Fancher*, *145 N. Y.*, *552*, the equitable lien of an unpaid vendor under a fraudulent sales contract, upon the proceeds of sub-sales of the merchandise, was enforced against a general assignee for the benefit of creditors, into whose hands the proceeds had come. ANDREWS, *C. J.*, said:

> "But general creditors have no equity or right to have appropriated to the payment of their debts the property of the plaintiff, *or property to which it was equitably entitled as between it and Burkhalter & Co.* They, so far as it appears, advanced nothing and gave no credit on the faith of the firm's pos-

session of the sugars, assuming that that element would have had any bearing on the case."

See also:

In the Matter of Howe, *1 Paige*, *125*, *and cases cited*;

Payne vs. *Wilson*, *74 N. Y.*, *348;*

Hamilton Trust Co. vs. *Clemes*, *163 N. Y.*, *423;*

National Bank of Deposit vs. *Rogers*, *166 N. Y.*, *380.*

(*g*) THE LOCAL LAW GOVERNS.

It is clear from the authorities above cited that the transaction infringed no statute of New York, and that the agreement was valid *inter partes*, and as against general creditors under the local law. Therefore, it must be upheld against the Trustee.

Hiscock vs. *Varick Bank*, *206 U. S.*, *28*, *38* ;

Thompson vs. *Fairbanks*, *196 U. S.*, *516* ;

Humphrey vs. *Tatman*, *198 U. S.*, *91* ;

Bryant vs. *Swofford*, *214 U. S.*, *279*, *290.*

SUMMARY OF POINT I.

The contract under which the drafts were accepted was a present contract for security on specified property and *either* passed the general property in the securities to the appellee, in which case no further argument is necessary, *or* created an equitable lien enforceable *inter partes*.

If the lien was inchoate prior to October 25, 19 7,

it was enforceable in a court of equity before that day and would have been preferred over everyone except *bona fide* purchasers for value without notice. The possession taken on October 25, 1907, merely ripened and perfected this inchoate lien, if it was inchoate, into a common law possessory lien, enforceable in an action at law, and the possession related back so as to cut off everyone except creditors who had intervened by execution or attachment, and *bona fide* purchasers. There were no purchasers, and the (now) bankrupts had never even defaulted in a payment prior to October 30, 1907, so there were no intervening rights of attachment or execution creditors. The agreement and the transactions under it were valid under the local law of New York and must be upheld here.

II.

The subsequent intervention of bankruptcy could not defeat appellees' right to the securities.

(*a*) THE TRUSTEE DOES NOT HAVE THE RIGHTS OF ATTACHMENT OR EXECUTION CREDITORS.

We discuss this point because decisions thereon of at least four Circuit Courts of Appeal have recently been overruled by this Court, and because we contend that even if possession had not been taken on October 25, 1907, we could have enforced our equitable lien under the contract against the trustee.

Loveland on Bankruptcy, 3rd Edition, at pages 438 and 450, refers at length to the erroneus de-

cisions of many lower Courts, including four Circuit Courts of Appeal which were overruled by *York Mfg. Co.* vs. *Cassell, 201 U. S., 344.*

In this last case the Court declared the law as follows:

> "Under the provisions of the Bankrupt Act the trustee in bankruptcy is vested with no better right or title to the bankrupt's property than belongs to the bankrupt at the time when the trustee's title accrued. * * * The trustee under such circumstances stands simply in the shoes of the bankrupt and as between them he has no greater right than the bankrupt. This is held in *Hewit* vs. *Berlin Machine Works, 194 U. S., 296.* The same view was held in *Thompson* vs. *Fairbanks, 196 U. S., 516.* It was there stated that 'under the present Bankrupt Act, the trustee takes the property of the bankrupt, in cases unaffected by fraud, in the same plight and condition that the bankrupt himself held it, *and subject to all the equities impressed upon it in the hands of the bankrupt*' (see *Yeatman* vs. *Savings Institution, 95 U. S., 764; Stewart* vs. *Platt, 101 U. S., 731; Hauselt* vs. *Harrison, 105 U. S., 401*). The same doctrine was reaffirmed in *Humphrey* vs. *Tatman, 198 U. S., 91.*"

In *Hurley* vs. *Atchison, Topeka & Santa Fe Ry., 213 U. S., 126, 132,* Mr. Justice BREWER quotes with approval the following language of Judge PUTNAM from *In re Chase, 59 C. C. A., 629, 631:*

> "It is settled that a trustee in bankruptcy has no equities greater than those of the bankrupt, and that he will be ordered to do full justice, even in some cases where the circumstances would give rise to no legal right, and, perhaps, not even to a right which could be enforced in a court of equity

as against an ordinary litigant (*Williams' Law of Bankruptcy, 7th Ed., 191*). Indeed, bankruptcy proceeds on equitable principles so broad that it will order a repayment when such principles require it, notwithstanding the Court or the trustee may have received the fund without such compulsion or protest as is ordinarily required for recovery in the courts either of common law or chancery."

In our case the bankrupts had received $384,000 as the proceeds of drafts accepted by the Manchester house just before bankruptcy, under the express agreement that it should be secured by the property set aside. The Manchester house is left to pay these drafts and the trustee seeks to compel it to surrender the security. *Such a demand by the bankrupts would have been preposterous.* It is difficult to understand how the trustee is in any better position.

The trustee in this case stands in the shoes of the New York copartnership. He has no greater rights than the New York firm could have asserted against the appellees. There was no judgment creditor of the bankrupt, and no levy in execution or attachment.

(*b*) THE TAKING POSSESSION ON OCTOBER 25, 1907, WAS NOT A PREFERENCE.

In *Sawyer* vs. *Turpin, 91 U. S., 114*, a chattel mortgage recorded just prior to bankruptcy was given in exchange for an unrecorded bill of sale of personal property. The bill of sale was unaccompanied by change of possession and was of such a character that it probably could not have been recorded. The bill of sale, however, was good between the parties, and no creditor had intervened. Judge STRONG, writing the opinion, said:

"It is too well settled to require discussion,

that an exchange of securities within the four months is not a fraudulent preference within the meaning of the Bankrupt Law, even when the creditor and the debtor know that the latter is insolvent, if the security given up is a valid one when the exchange is made, and if it be undoubtedly of equal value with the security substituted for it (Citing *Cook* vs. *Tullis, 18 Wall., 340; Clark* vs. *Iselin, 21 id., 260; Watson* vs. *Taylor, 21 id., 378*, and *Burnhisel* vs. *Firman, 22 id., 170*).

It follows that the mortgage of July 31st was not prohibited by the Bankrupt Act when it was given, and that it was valid. Hence, as it was recorded on the 17th day of September, 1859, pursuant to the requisitions of the State law, before any rights of the assignees in bankruptcy accrued, it cannot be impeached by them.

It has been argued, however, on behalf of the assignees, that the bill of sale of May 15th was an insufficient consideration for the mortgage, because, as alleged, there was an agreement between Bacheller and Turpin that it should not be recorded, and should be kept secret. If the fact were as alleged it is not perceived that it would be of any importance; for it is undeniable that the bill of sale rested on a valuable consideration—to wit, the debt of $27,839 gold, due to Novelli & Co.; and it is not denied that it gave to Turpin the right to take possession of the property described in it. It was, therefore, a valuable security, even if there was an agreement not to record it. If it be said failure to put it on record enabled the debtor to maintain a credit which he ought not to have enjoyed, the answer is that the Bankrupt Act was not intended to prevent false credits. Its purpose is ratable distribution. But the evidence does not justify the assertion that there was in fact any agreement that the bill of sale should not be recorded, or that possession should not be taken under it."

In *Humphrey* vs. *Tatman, 198 U. S., at page 94*, Mr. Justice Holmes, writing the opinion, said of *Sawyer* vs. *Turpin, supra*, that it is

> "a case like the present, decided as we decide this, and cited by the Court below."

Humphrey vs. *Tatman, supra*, reverses *Tatman* vs. *Humphrey, 184 Mass., 361*, on the authority of *Thompson* vs. *Fairbanks, 196 U. S., 516*.

The defendant in the *Tatman* case had taken possession of the bankrupt's entire stock of jewelry about three weeks before bankruptcy, claiming it under an unrecorded chattel mortgage executed about two years earlier when the bankrupt was solvent. Under the Massachusetts statute an unrecorded mortgage "was not valid against any other person than the parties thereto."

The Massachusetts Supreme Court said :

> "The defendant's acquisition of possession of the mortgaged property before the commencement of the proceedings in bankruptcy, and before third persons had acquired liens or rights by attachment or otherwise, gave him a title which was good at common law against creditors, and which would have been good against an assignee in insolvency under the statutes of this Commonwealth, or against an assignee in bankruptcy, under the United States Bankruptcy Act of 1867 (*Folsom* vs. *Clemens, 111 Mass., 273* ; *Chase* vs. *Denny, 130 Mass., 566* ; *Blanchard* vs. *Cooke, 144 Mass., 207* ; *Bennett* vs. *Bailey, 150 Mass., 257*; *Bliss* vs. *Crosier, 159 Mass., 498* ; *Haskell* vs. *Merrill, 179 Mass., 120* ; *Gibson* vs. *Warden, 14 Wall., 244* ; *Sawyer* vs. *Turpin, 91, U. S., 114*).

The Court then discussed the provisions of the Act of 1898 which differed in regard to preferences and acts of bankruptcy from the Act of 1867.

"In view of these several provisions and

the language of Sections 60*a* and 60*b*, and the construction put upon the statute by the Supreme Court of the United States, we are of the opinion that, in the case of a preference by way of an unrecorded chattel mortgage, the transfer dates, under the Bankruptcy Act of 1898 and the Amendatory Act of February 5, 1903, from the acquisition of possession under the mortgage.

In *Matthews* vs. *Hardt*, *79 App. Div.*, (*N. Y.*), *570* (*9 Am. B. R.*, *373*), the Appellate Division of the Supreme Court of New York, in a well-considered opinion, made a decision which entirely covers the present case."

In reversing the Massachusetts Supreme Court, this Court (Mr. Justice Holmes writing) said:

"The question then is one of Massachusetts Law." * * *

"As the Supreme Court of Massachusetts says that taking possession under the mortgage within four months would be valid as against the trustee in bankruptcy but for supposed peculiarities of the present bankruptcy law, and as *Thompson* vs. *Fairbanks*, *196 U. S.*, *516*, although distinguishable from the present case, decides that it is valid under the present bankruptcy law if good by the laws of the State, it follows that the mortgagee was entitled to keep his goods and that the judgment against him was wrong."

It is clear that *Matthews* vs. *Hardt*, *79 N. Y. App. Div.*, *570*, was overruled on the same point by *Humphrey* vs. *Tatman*, *supra*.

In short, the recent decisions of this Court have overruled two prevalent theories in regard to the present Bankrupt Act; (1) that the trustee has any greater title than the bankrupt or can ordinarily enforce any rights other than those of *simple contract creditors*; (2) that there are any "peculiar provi-

sions" of the present act which invalidate a lien or title which is good under the local law against the bankrupt and his general creditors.

It must be conceded that if appellee on October 25, 1907, had a contract right to have the securities held as security for its obligation upon the acceptances, then the possession taken on that day could not have been a preference.

To find a preference, the Court must declare that the contract under which the drafts were accepted was a nullity. It is conceded, however, that it was a valid contract enforceable in equity *inter partes.* The possession taken on October 25, 1907, could not, therefore, have been a preference.

III.

The bankrupt's general creditors had no property right in the securities and appellees' contract was enforceable as against creditors.

(*a*) IT IS A CASE UNAFFECTED BY FRAUD.

Judge WARD, writing for the Circuit Court of Appeals below, said:

> "As the transaction was a perfectly honest one, a construction should be adopted to give it effect, if that is possible."

Judge NOYES, writing the concurring opinion in the same Court, said:

> "In considering the case from any point of view, one thing is apparent from the outset, and that is the good faith of the parties."

The Master and the District Judge did not question the absolute good faith and honest intent of the parties, and we assume that it is quite unnecessary to dwell further upon the point.

The only question is whether the possession taken on October 25, 1907, by the defendant was a voidable preference under Section 60 of the Bankrupt Act.

(*b*) THERE WAS NO ESTOPPEL.

Security was the only object of the agreement.

The debtor derived no benefit or advantage by retaining physical control.

Everything that was done or intended could have been accomplished as well if the securities had been delivered in escrow to a third person. They were just as much removed from the working assets as if they had been handed to appellee.

There was no agreement for beneficial use. The debtors were not permitted "to sport with the property" (Chancellor KENT'S phrase). Nor did they.

At the time of taking out they must put in securities of equal or greater value. This was done. The value of the deposit was never depleted.

The securities were all American stocks, bonds, notes and deeds, and must of necessity remain here, while appellee resided in England. Appellee was willing to trust the debtors to perform this agreement and to hold the securities strictly for appellee's account as its property. This trust was never once violated during the four and one-half years of the agreement. It was a complete and absolute *appropriation* of specific property by the debtors as security for the obligation.

Had the debtors attempted to violate the contract or deplete the security, they would have immedi-

ately lost the benefit of the contract, which was continuing. Appellee would have refused to accept more drafts and could have compelled the delivery of the securities either to them or to some officer of the court to be held for their benefit. All changes, according to the agreement, were immediately reported, noted and, if satisfactory, accepted by defendant.

No false credit was made possible by the agreement.

The debtors were not merchants. The property was not chattels. The debtors were not ordinary bankers. They were foreign bankers. The great volume of their business was buying and selling foreign exchange. They sometimes purchased foreign bills here for cash and then drew against them. They also had constant drawing credits with numerous foreign houses. Practically all of these foreign drawing credits were secured by the deposit of collateral. Their profit was in the saving of interest and in the difference of the rates of exchange.

In this country the debtors were lenders and purchasers for cash, not borrowers.

They did not seek credit, except secured credit, with foreign houses. Consequently, practically their entire capital was pledged to foreign houses to secure drawing credits. There was no secret about this. It is the condition of every "foreign banker" when exchange business is good.

The shrinkage in value of these pledged securities caused their failure.

The debtors never attempted to repledge or to sell appellees' securities. Had they done this a *bona fide* purchaser for value without notice might have arisen. In this case there is not even a judgment creditor nor a levy in attachment. The se-

curities were never sold nor repledged while they remained in the "escrow." The debtors, down to the time of bankruptcy, met all of their obligations as they fell due. Nobody purchased, no one obtained a judgment and no one levied.

Nobody who dealt with these debtors knew or could have known, or cared, whether the securities set aside were validly pledged or not. No one dealt with the debtors, in reliance upon their ownership of these securities, or even knew of the physical possession of the package by the debtors. The debtors were not permitted to, nor did they in any manner "sport with the property."

A valid pledge of securities is usually secret.

In *Stackhouse* vs. *Holden, 66 N. Y. App. Div., 426*, Mr. Justice NASH remarked:

> "Every pledge of securities may be and generally is done in secret. The dealings had with mercantile houses are always with knowledge that available bills and accounts receivable may be so used to procure credit or capital."

Much more is it true that persons dealing with these foreign bankers know that their securities probably are pledged for foreign drawing credits. No reliance was placed upon any visible ownership. No one was misled in giving credit. The books of account were correctly kept and showed that these securities had been deposited to secure the drawing credit which defendant accorded.

(*c*) THE LAW AS TO CHATTELS DOES NOT APPLY.

The distinction between incorporeal personalty and "goods and chattels" is important in this case and has already been dwelt upon above.

It is clearly established by the New York au-

thorities (discussed at length *infra* under Point V) that a general creditor cannot attack a legal or equitable assignment of property of this character where there is no actual fraud.

> *Niles* vs. *Mathusa, 162 N. Y., 546;*
> *McNeeley* vs. *Welz, 166 N. Y., 124;*
> *Central Trust Co.* vs. *West India Imp. Co., 169 N. Y., 314;*
> *Young* vs. *Upson, 115 Fed. Rep., 192.*

(*d*) THE NEW YORK CASES.

We have already referred to these under Point I of this brief. It is clear that in the absence of fraud, or statutory inhibition, general creditors have no rights whatever in the debtor's property or to set aside a transfer. It must be conceded that there was an entire absence of fraud in our case and that there is no statutory inhibition which makes our contract void as against general creditors. It is difficult to understand from what source the trustee would acquire a right to attack this transfer. Neither the bankrupt nor its general creditors had such a right. The trustee stands in the shoes of the bankrupt. He can ordinarily enforce only the rights of general creditors.

The appellant, in the last analysis, must take one of two positions. He must assert that the contract created no right in the appellees to the securities either (1) because it was too indefinite to be enforceable *inter partes* by a court of equity; or (2) because it was fraudulent in law and hence void against general creditors.

Both of these contentions are untenable. The contract is concededly enforceable in equity, *inter partes*, and we show, *supra* (*Point IIIc*) and *infra* (*Point V*) that this contract is not fraudulent in law.

IV.

The Circuit Court of Appeals was right in reversing the decree of the District Court.

The opinion of the learned District Judge below having been wholly based upon the hypothesis that the agreement was only

> "an agreement to validly and lawfully pledge certain property on demand,"

both Judge WARD and Judge NOYES, writing for the Circuit Court of Appeals (Judge LACOMBE concurring, for reasons stated in Judge NOYES' opinion), examine closely this hypothesis and discard it.

As Judge WARD says (*R., 1135*):

> "The intention to secure is plain, but this could have been accomplished not only by a pledge, which is the usual course of business in case of choses in action, but by a mortgage or trust. * * * As the transaction was a perfectly honest one, a construction should be adopted to give it effect, if that is possible."

He then points out that if the transaction be regarded as a mortgage, it was undoubtedly valid against the trustee in bankruptcy under the law of New York.

He also points out how astute the New York Courts have been to carry out the intention of the parties, in the trust receipt cases cited under Point I of our brief.

He concludes that the transaction was a declara-

tion of trust, and that the New York copartnership, in delivering the securities just prior to bankruptcy, only did what a court of equity would have compelled it to do. He says :

> "No new right or privilege was then created voidable under the Bankrupt Act. The delivery of these earmarked securities was in strict pursuance of the agreement made long before on the strength of which the credit was given. *Sabin* vs. *Camp, 98 F. R., 974*, cited with approval in *Thompson* vs. *Fairbanks, 196 U. S., 516, 524*. A liberal construction should be given to these transactions in aid of the obvious intention of the parties."

Judge NOYES (Judge LACOMBE concurring) differs from the conclusion of Judge WARD that the transaction was a declaration of trust, while concurring with him in the result (*R., 1138*).

He emphasizes the absolute good faith of the parties.

He then distinguishes between a mortgage and a pledge, and points out the peculiarity of a pledge of choses in action.

After referring to the fact that the securities were endorsed for transfer, before being set aside, he says (*R., 1141*) :

> "But the equities of the case coupled with what the parties did—aside from any technicality—make out a strong case in support of an equitable lien in the nature of a mortgage upon the security in favor of the Manchester house, valid against the trustee in bankruptcy without a change in possession."

Again (*R., 1141*):

> "Now, there being no fraud in the transaction and no rights of purchasers or attach-

> ing creditors having intervened, the taking possession of the securities by the Manchester house before the bankruptcy, was, in the absence of a statute making it unlawful, entirely legal and proper. Regarded simply as a pledge, the pledgee had the right to take possession" (citing *Parshall* vs. *Eggert*, *54 N. Y.*, *18*).

Judge NOYES inclines strongly to the opinion that the original transaction was a mortgage. (*R.*, *1140*).

Judge NOYES apparently rests his decision, however, upon two very safe grounds, as follows (*R.*, *1144*):

> "It is my opinion that possession was taken pursuant to a pre-existing right and that equitable principles support such right. I think that this is in no aspect a case of the bald creation of a lien within four months of bankruptcy.
>
> Finally, I think it a serious question whether a mortgagee or pledgee taking possession of property in pursuance and in the enforcement of a pre-existing right of long standing can properly be said to have reasonable cause to believe that the mortgagor in surrendering possession is intending to give him a preference."

The error of the learned District Judge below is indicated by the following quotation from his opinion:

> "What, then, does 'equitable lien' mean as applied to this transaction? Nothing more than an endeavor to enforce an agreement for a pledge, unaccompanied by any contemporaneous transfer of possession. In my opinion no such equitable lien does or can exist; it would be a contradiction in terms, and amount to a most inequitable infraction of the law of pledge (*Buffalo G. I. Co.* vs. *Third National Bank*, *162 N. Y.*,

163; Wilson vs. *Little, 2 N. Y., 446; Security Warehouse Co.* vs. *Hand, 206 U. S., 415.)*"

His error seems to us to rest in the assertion that equity follows the law of pledge. An equitable lien is not in the nature of a pledge. It is in the nature of a mortgage.

Pomeroy Eq. Juris, §§ 1233, 1234;
Hausell vs. *Harrison, 105 U. S., 401.*

Equity enforces the contract, not the pledge. A contract for a pledge, ineffective for want of delivery under it, is not void against creditors.

Parshall vs. *Eggert, supra;*
National Bank of Deposit vs. *Rogers, supra;*
Hausell vs. *Harrison, supra.*

A mortgage which was neither acknowledged nor witnessed nor recorded and hence invalid by statute, was given in *Payne* vs. *Wilson, 74 N. Y., 348.* The *contract*, however, was enforced as an equitable lien valid as against subsequent mechanics' lienors and judgment creditors.

The learned District Judge, after erroneously characterizing our contract as a contract to validly and lawfully pledge certain property on demand, says (*R., 1093-4*):

> "Now it may be assumed that such agreement was and is valid in equity *inter partes;* but equity will not enforce it, as against the rights of other creditors as represented by a trustee in bankruptcy. This I believe to be the law of New York, as disclosed in *Zartman* vs. *First National Bank, 189 N. Y., 273.*"

Judge NOYES, in the Circuit Court of Appeals, said (*R., 1144*):

> "The case of *Zartman* vs. *First National Bank, 189 N. Y., 273*, relied upon by the appellee (now appellant) as his principal case upon this point, is not in conflict with these views. In that case there was merely a contract to give a mortgage upon after-acquired property. There was no lien which could have been enlarged or perfected by taking possession."

A careful reading of the opinions in both Courts below reduces the case to this one issue, viz.:

Whether the contract of June 30th, 1903, was a mere promise to give security upon demand or if required, and hence not enforceable, as the learned District Judge apparently held, *or* whether, as Judge NOYES stated, the taking of possession on October 25, 1907, was:

> "The exercise of a pre-existing right well founded in equity" and therefore "not a preference although occurring within the prescribed period" (*R., 1143*).

The District Court erred and the Circuit Court of Appeals properly reversed its decree, because

1. It is only in cases of fraud or express statutory inhibition that the rights of general creditors may be said to intervene in equity.

> *Parshall* vs. *Eggert, 54 N. Y., 18;*
> *Payne* vs. *Wilson, 74 N. Y., 348;*
> *McCaffrey* vs. *Woodin, 65 N. Y., 459;*
> *American Sugar Refining Co.* vs. *Fancher, 145 N. Y., 552;*
> *Niles* vs. *Mathusa, 162 N. Y., 546.*
> *Hamilton Trust Co.* vs. *Clemes, 163 N. Y., 423;*

National Bank of Deposit vs. *Rogers*, *166 N. Y., 380;*
Hauselt vs. *Harrison, 105 U. S., 401;*
Thompson vs. *Fairbanks, 196 U. S., 516;*
Humphrey vs. *Tatman, 198 U. S., 91;*
York Mfg. Co. vs. *Cassell, 201 U. S., 344.*

2. It is not necessary (as the learned District Judge infers, *R. 1093*), that appellees' title should have been enforceable in an action at law four months before bankruptcy. Nor was the test whether the appellees could have then maintained an action of replevin.

The cases last cited all show this. The case of *National Bank of Deposit* vs. *Rogers, supra*, affords a striking instance to the contrary, because the plaintiff in that case first brought an action at law and the complaint was dismissed. The plaintiff then brought a suit in equity, and its equitable lien arising from the express contract for security was enforced against the assignee for the benefit of judgment creditors.

3. The statement of the learned District Judge, that the property was not sufficiently identified to create an equitable lien (*R., 1092*) is hopelessly inconsistent with his later statement that the agreement was and is valid in equity *inter partes* (*R., 1093-4*).

Pomeroy Eq. Juris., § *1234.*

4. The enforcement of an equitable lien will not be denied because it is an infraction of the law of pledge. The District Court's contrary holding is fundamental error.

This contention is discussed and its fallacy

pointed out in *Goodnough Mercantile & Stock Co.* vs. *Galloway, 156 Fed. Rep., 504*, and cases cited.

We had an enforceable contract for present security. If there was a valid pledge, resort to a court of equity to enforce the contract for security was clearly unnecessary. All common law liens are possessory. A common law mortgage is strictly a conveyance, not a lien. Hence, as this Court said in *Hauselt* vs. *Harrison (supra)*, an equitable lien is in the nature of a mortgage, not of a pledge. The contract, which can be specifically enforced, takes the place of the conveyance or mortgage, unless, as we also contend, there was a valid common law mortgage of the property. The Circuit Court of Appeals below, goes very far towards sustaining the latter contention.

5. Appellees have a valid legal title against which the trustee cannot prevail. This legal title is not a voidable preference because it was exchanged for an equally valid equitable title.

> *Sawyer* vs. *Turpin, 91 U. S., 114;*
> *Humphrey* vs. *Tatman, 198 U. S., 91.*

6. Our contract was neither *malum in se* nor *malum prohibitum.* It was a *bona fide* present contract for security upon specified appropriated property. Its sole object was security. It was not calculated to defraud and, as Judge Ward said, it never did defraud or mislead anybody. It was not void by statute.

7. Under the New York law, such a contract concededly being enforceable in equity *inter partes,* it was enforceable against the trustee in bankruptcy, who only represented the bankrupts and their general creditors. The contract was not void against general creditors.

> *Humphrey* vs. *Tatman, supra.*

We have attempted, under this Point, to indicate briefly the fundamental errors underlying the decision of the District Court, which called for a reversal of its decree. We have cited throughout our brief the numerous decisions of the New York Courts, as to the local law, and of this Court, upon the question of a voidable preference, showing that the decree of the Circuit Court of Appeals should be affirmed.

V.

The authorities relied upon by appellant are not applicable.

These cases are :

Zartman vs. *First Nat. Bank, 189 N. Y., 267;*
Casey vs. *Cavaroc, 96 U. S., 467;*
In re Great Western Mfg. Co., 152 Fed. Rep., 123.

The *Zartman* case and *N. Y. Security & Trust Co.*, vs. *Saratoga Gas & Elect. Light Co., 159 N. Y., 137*, are cases which belong to a different class from ours. Both construed clauses in corporation mortgages, given to secure bond issues, which purported to cover all after-acquired property and provided that as to the shifting stock and material (in the one case) and as to the earnings (in the other) *the mortgagor should until default remain in possession with the full beneficial use and enjoyment thereof.*

These clauses of the mortgages were fraudulent in law, under the doctrine of *Southard* vs. *Benner*,

72 N. Y., 424. Furthermore, as to the property in question, they are so utterly inconsistent with any lien or any present agreement for a lien, that the Court says they are a nullity. The agreements as to such after acquired property were in substance to give a lien after default upon such property as might by chance belong to the mortgagors at that time. They were so general and indefinite that they will be disregarded (*Lowell on Bankruptcy,* § *86, supra*). The lien was not to attach, according to the agreements, until possession was taken at some future time, and the agreements did not specify any property to which it was to attach, other than such property of the description as the mortgagor might then have. The *Zartman* case is clearly distinguished from the present case by Judge NOYES in the opinion of the Circuit Court of Appeals.

Our agreement was essentially different from this. In the first place, it was not fraudulent in law, for it did not give the debtor beneficial use of the property. Its object was security and nothing else. The debtor could remove property from the package only by replacing it with other property of equal or greater value, and the value of the security could not be depleted. In the second place, our securities were set aside and held for the account of defendant as security for its obligation upon its acceptances. It was not an agreement for a lien at some future, indefinite time, but an agreement for *present* security. Nothing whatever was said about the defendant taking possession at some future time. The parties regarded the transaction as having effectually created security on property which was set aside and clearly specified. To hold otherwise is to construe the entire contract as meaning nothing, whereas the letters show clearly that the parties intended present security. In the *Zart-*

man case and the *N. Y. Security & Trust Co.* case, only a relatively insignificant part of the mortgages was held void, viz., that which related to shifting stock and materials and earnings. In our case, the District Court's denial that the parties intended any present security whatever, is palpably inconsistent with the plain language of the agreement and with the whole course of dealings between the parties and that Court was properly reversed by the Circuit Court of Appeals.

The following language of the opinion in the *Zartman* case, however, is contrary to the construction of the Bankrupt Act by this Court in *York Mfg. Co.* vs. *Cassell, supra:*

> "The plaintiff, as trustee in bankruptcy of the mortgagor, has the same rights *as a creditor armed with an attachment or execution* (*Skilton* vs. *Codington, supra; In re Werner, 5 Dill., 119; In re Garcewich,* 8 *Am. Bank Rep., 149; U. S. Bankruptcy Act of 1898, Section 70*)."

If this language is to be taken literally, it is bad law, and would not be followed by this Court (*Zartman* vs. *Bank, 216 U. S., 134, 138*). We think, however, that Mr. Justice VANN clearly meant that where the contract is absolutely void as against general creditors (either *malum in se* or *malum prohibitum*) the local requirement that a creditor seeking to attack it must first issue execution on a judgment will be dispensed with where the action is brought by a trustee in bankruptcy.

This view is greatly strengthened by the fact that Mr. Justice VANN was deciding a case in which the contract was absolutely void as against general creditors.

There can be no doubt whatever, that in the absence of fraud or statutory inhibition making the contract void as against general creditors, no rights

of general creditors intervene and none are represented by the trustee.

Judge NOYES in the Circuit Court of Appeals below, distinguishes the *Zartman* case as follows (*R., 1144*):

> "In that case there was merely a contract to give a mortgage upon after acquired property. There was no lien which could have been enlarged or perfected by taking possession."

In re Great Western Mfg. Co., 152 Fed. Rep., 123, was a case where the bankrupt had purchased machinery and material for its mill, under the ordinary contract of conditional sale. This contract contained a clause that the notes of the vendee should "*be secured by first mortgage on said premises and appurtenances or equivalent security, at the first party's (the vendor's) election.*" A mortgage on the mill site and mill was given just prior to bankruptcy when the vendor had full knowledge of the vendee's hopeless insolvency. The vendor's title under the contract of conditional sale was held good against the trustee, but the mortgage was held to be a voidable preference.

The clause in this contract in the *Great Western* case was (to borrow Lowell's exact language, *supra*) "a general covenant for further security." It was a promise to give further security by way of a first mortgage on real estate, *or equivalent security, when required at the creditor's election*, and so indefinite. The language here is almost identical with the language of the contracts in the cases cited by Lowell on Bankruptcy, Section 86, to which we have previously referred at some length. The agreement was in the future tense. Until the mortgage was given there was no present agreement for security on any specific property. The election to have further security was made just be-

fore bankruptcy (see also *Page* vs. *Rogers, 211 U. S., 575, 579*).

To say that the contract of June 30, 1903, and all the subsequent agreements under which about two hundred and fifty drafts were accepted by appellee, did not sufficiently indicate an intention to make the particular property which was placed in a separate package, marked and entered in the books as appellee's property, set aside in a vault where it remained, treated and accounted for at all times by the bankrupts as appellee's property, and finally surrendered to appellee without objection on demand, a security for appellee's obligation, is to violate the express provisions of a simple contract.

The three cases of *Casey* vs. *Cavaroc*, *Same* vs. *National Park Bank* and *Same* vs. *Schuchardt*, arose under the Civil Code of Louisiana. The law of Louisiana relating to the pledge or pawn of stocks, bonds and promissory notes is fixed by statute and is different from that of England and of every other State in the Union. These cases were decided by a divided Court. Mr. Justice SWAYNE, Mr. Justice FIELD and Mr. Justice HARLAN dissenting in each case.

Casey vs. *Cavaroc* was a suit in equity by the receiver of a national bank to recover possession of securities alleged to have been delivered by the bank to Cavaroc & Son, in contemplation of the insolvency of the bank, not by way of pledge, but with a view of giving a preference to Cavaroc & Son and the Credit Mobilier over other creditors of the bank, contrary to Section 52 of the Louisiana banking act.

The defendants by their answers denied the preference and insisted "that they were actually pledged to the society by virtue of a distinct agreement."

The agreement is set forth in correspondence between Cavaroc, president of the bank, and the Credit Mobilier, from which it appears that the Credit Mobilier entered into a profit and loss sharing arrangement with the bank, by which it was to accept drafts drawn on it by the bank, and the funds realized from the sale of these drafts were to be used in the purchase of securities which were to be deposited with Cavaroc & Son. The bank was to guarantee the investment, interest was to be carried to the credit of the joint account, and the profit and loss was to be divided equally between the Credit Mobilier and the bank.

There was no agreement for a pledge or lien of any kind on the securities. The only agreement was that the proceeds of the drafts should be used in the purchase of securities which should be deposited with Cavaroc & Son, and that profit and loss should be shared (see *p. 469 of Opinion*). This agreement was made during the summer before the bank failed but while it was insolvent and its insolvency suspected by many business men of New Orleans and its stock totally unsalable.

The securities were handed to Cavaroc and by him handed back to the cashier of the bank. They soon found their way into the hands of the discount clerk of the bank, where *they were used by the bank in the ordinary course of its business.* No entry was made on the books of the bank of the transaction.

> " *The pledge of the securities was not noticed. These all remained on the portfolio of bills discounted, as before, and their amount continued to be represented in the daily and monthly statements, without any note or memorandum to show that they had been pledged. So far as the public, and those with whom the bank dealt, could perceive, the bank continued to have possession*

> *and control of all the securities in its own right, and they all appeared to be equally liable with the other assets to the claims of all the creditors.*"

The statute of Louisiana reads :

> " That where a debtor wishes to pawn promissory notes, bills of exchange, stocks, obligations, or claims upon other persons, he shall deliver to the creditors the notes, bills of exchange, certificates of stock, or other evidences of the claims or rights so pawned ; and such pawn so made, *without further formalities*, shall be valid as well against third persons as against the pledgors thereof, if made in good faith."

Louisiana is the only State in which a mere delivery of the certificate or note, without more, constitutes a valid pledge (see *Nisbit* vs. *Macon Bank, 12 Fed. Rep., 686*). Everywhere else some written transfer or contract is necessary for a pledge of stock to be good against third parties.

Article 3162 of the Louisiana Code reads :

> " In no case does this privilege subsist in the pledge except when the thing pledged, if it be a corporeal movable, or the evidence of the debt, if it be a note or other obligation under private signature, has been actually put and remained in the possession of the creditor, or of a third person agreed on by the parties."

The question, therefore, was whether the scrip " had been actually put and remained in the possession of the creditor, or of a third person," so as to create a pledge under this statute.

These statutes and others are set forth in the opinion as the basis of the decision (*pp. 481 et seq.*).

It was held that inasmuch as these securities remained in the possession and control of the bank there was no pledge under the Louisiana law.

The Court then continued (*p. 486*) :

> "*It must not be overlooked that the Credit Mobilier has no other claim to the securities in question but that of pledge.* A pledge, and possession, which is its essential ingredient, must be made out, or their privilege fails. An agreement for a pledge raises no privilege. There is no mortgage, for the title of the securities was never transferred to them. The evidence of the cashier is that they were all stamped payable to the order of the bank when discounted. *They were not indorsed by the cashier until the day they were removed by Cavaroc, which was after the bank had failed.*"

Of course there was no other claim in that case but that of a pledge. Nothing else was pleaded or could have been successfully pleaded. There was no mortgage and no agreement for a lien on the securities. There was merely an agreement that they should be deposited, which was not done. If the agreement had been carried out and the deposit made there might have been a good pledge under the Louisiana law. It is perfectly manifest that the only question before the Court was whether the technical requirements of the peculiar statute of Louisiana had been complied with so as to create a pledge of paper securities. The Court held that these requirements had not been complied with, but such a decision has no application whatever to the case at bar. The agreement in *Casey* vs. *Cavaroc*, which was merely that certain securities should be deposited in a certain way, which was not done, was void by Louisiana statute as against general creditors and hence void against the receiver (*p. 489*). This is made even clearer at *page 490*, where the Court says :

> "Where the legal or equitable property

in a security passes, and there is no express law invalidating the transfer, the creditor will be entitled to hold it as well against the assignee or receiver as against the debtor; * * * but in the present case that question does not arise; or, if it might be raised, it is immaterial. The Credit Mobilier claims a privilege by virtue of a pledge; and such a privilege, as we have seen, cannot be maintained as to third persons without possession."

Finally, at the very conclusion of the opinion, the Court says (*p. 491*):

> "This suggestion (that equity will consider as done what the parties intended should be done) may also be answered by the fact that it cannot be truly said to have been the intent of the parties to transfer the title. *The agreement was only that 'securities of the first class shall be deposited with the firm of Messrs. Cavaroc & Son.'*"

Casey vs. *National Park Bank*, and *Casey* vs. *Schuchardt*, are decided on a narrower ground than *Casey* vs. *Cavaroc*. The agreement in the *National Park Bank* case would certainly amount to a declaration of trust under the law of New York and create an equitable lien on the securities, unless the doctrine of estoppel were invoked. The facts are essentially and vitally different from the facts in our case, as stated by the Court at *page 493*:

> "The bills were never removed from the bank, and were never endorsed by it, until the bank failed; and were always kept on the portfolio of bills receivable, without any entry on or in the reports to show that they had been pledged. * * * There was no such possession by or on behalf of the Park Bank as would constitute a valid pledge as to third persons."

It will be noted that the only defense pleaded in this case was that of a valid pledge. We believe that the decision turned upon this question of pleading. This is shown by the Court's language in the *Schuchardt* case as follows (*p. 495*):

> "As the only claim made by Schuchardt & Sons, in their answer, to the securities in question is by way of pledge, and as there was no such delivery and retention of possession by them, or their agents or trustees, as the law requires, to constitute the privilege of a pledge as to third persons, their claim cannot be sustained."

It is certainly clear that all that was decided in these three cases was that what was done in each of them was not sufficient to constitute the privilege of a *pledge* as to third persons, under the peculiar provisions of the Louisiana Code. These cases are clearly and rightly distinguished by the Court below from the present case.

The very same Court, in a case reported in the same volume (*Gregory* vs. *Morris*, *96 U. S.*, *619*), held that the legal effect of a contract for security on specific property is to create a charge upon the property, not in the nature of a pledge, but of a mortgage. This doctrine was reaffirmed in *Hausell* vs. *Harrison*, *105 U. S.*, *401.*

We are not, in the case at bar, dealing with a promise to do something which was not done. It is not a promise to set aside securities. *The securities were actually set aside and remained earmarked and identified.* There was an express executory agreement that these particular securities, therein described and identified and set apart, should be security for defendant's obligation.

Ryttenberg vs. *Schefer*, *131 Fed. Rep.*, *313*, cited by the Master in his opinion, is similar to *Casey* vs. *Cavaroc*, as we read the latter decision. *There*

was no agreement for a lien. Judge HOLT in his opinion, at *page 322*, states the precise point with great clearness:

> "The defendants claim that, if there was no pledge at common law in this case, there was an equitable lien. Courts have undoubtedly gone far in some cases to uphold an equitable lien for the protection of parties who have made advances under agreements for liens. It is difficult to reconcile all the cases. But, in my opinion, under all the circumstances of this case, there is no adequate proof of an equitable lien. *In the first place, it must be borne in mind that there was no specific agreement for an equitable lien.* The agreement was simply that Radon & Co. should do their business through the defendants, and that all their goods, whether consigned or owned, should be consigned to the defendants as factors for sale upon commission. The entire claim of the defendants for a lien is based upon the assumption that they did act as factors, and that Radon & Co. did consign all the goods which they had to them, and that therefore they have the lien which the law gives a factor on the goods and accounts. * * * All the cases which have been called to my attention in which the facts are somewhat similar to those in this case, and in which an equitable lien has been upheld, are cases in which either there was a specific agreement for a mortgage or lien of some kind, or the goods, although remaining about the premises of the party giving the lien, were set apart in a lot or room leased to the party to whom the lien was to be given, and were delivered into the custody and control of an agent of the person to whom the lien was to be given.

The simple fact in this case is that Radon & Co. wanted to obtain advances without delivering possession of the property, and Schefer, Schramm & Vogel wanted to acquire a lien without taking possession of the prop-

erty. It was one of the numerous attempts to give a lien by owners of property while retaining the apparent ownership of it."

The agreement upon which the claim of lien which Judge HOLT is discussing was based was a single clause of a long written contract as follows:

> "All goods at present consigned or owned by Radon & Co. shall be consigned by these respective owners to Schefer, Schramm & Vogel as factors for sale upon commission."

The goods in question were never consigned by Radon & Co. or any one else to Schefer, Schramm & Vogel, but remained in the open, notorious possession of Radon & Co. at the time of the bankruptcy of Radon & Co. There was no possessory lien and there was no "express executory agreement in writing, whereby the contracting party sufficiently indicates an intention to make some particular property * * * therein described or identified, a security for a debt or other obligation."

In *Casey* vs. *Cavaroc*, *supra*, and *Ryttenberg* vs. *Schefer*, *supra*, the question under discussion is whether, in the absence of any agreement for a lien, what was done was sufficient to constitute a pledge. *In our case we are discussing the question whether an express executory agreement in writing, whereby the contracting party indicates a clear intention to make specific property, earmarked and set aside, a security for an obligation, creates an equitable lien in the property good as against the trustee in bankruptcy.* When the question is fairly stated, the answer seems too clear for argument.

The Master's statement that *Wood* vs. *U. S. Fid. & Guar. Company*, *143 Fed. Rep.*, *424-6* (which was one of a great number of cases, both State and Federal, cited on defendant's brief below in support of its contention that it had an equitable lien on

the securities) is overruled by the *In re Great Western Mfg. Co.* case, if inconsistent with that case, and that it is distinguishable from the case at bar in the nature of the language used, which was held to have created a lien as against the trustee in bankruptcy is erroneous.

In the *Wood* case, the bankrupt was a contractor in the employ of the United States Government, and agreed with the Surety Company which went on his bond, as follows :

> " We do further agree in the event of our being unable to complete or carry on the aforesaid contract, to assign, and we do hereby assign, such plant as we may own or have upon said work, to the said United States Fidelity & Guaranty Company."

After the bankrupt was notoriously insolvent and had abandoned his contract, and just before bankruptcy, the Surety Company took possession of his plant and materials on the job, for the purpose of completing the contract.

The trustee in bankruptcy brought an action in the United States District Court in Massachusetts, to set aside the transfer as a voidable preference. *Held*, no preference. Judgment for defendant.

The Court said :

> " The exercise by the defendants of the right to take it thus acquired, though within four months of the bankruptcy, and notwithstanding its knowledge, whether actual or imputed, that King was then insolvent, did not bring about a preference in its favor (see *Lowell on Bankruptcy, Sec. 86, p. 67 ; In re Jackson Iron Mfg. Co., Fed. cases, No. 7153*). King's consent to the taking, or that of the common law assignees, in whom the title to all his property was then vested, so far as he could vest it in them, was, therefore, a consent to what they could

not lawfully oppose. The auditor finds that it was given in the belief that the defendant was lawfully entitled to the property, and that neither he nor they nor the defendant believed or had reasonable cause to believe that any preference was intended. According to the view of the matter above taken, these findings must be approved. There is nothing to show any fraudulent intent on the part of King or the defendant towards other creditors, so far as the taking is concerned, or to show any intent other than to carry into effect the right given by the indemnity agreement.

Assuming that it (the property) was all acquired by King after the execution of the indemnity agreement the defendant's claim to it when it was taken was, in my opinion, none the less valid. The defendant's right to the property is still as in *Thompson* vs. *Fairbanks*, *196 U. S.*, *517*, and *Humphrey* vs. *Tatman*, *198 U. S.*, *91*, to be judged not by the state of facts existing when possession was taken, but by the state of facts existing when the right was given. Since possession was taken before bankruptcy, the defendant, upon taking possession, held the property by a title relating back to the time when the right was acquired, at which time, so far as appears, there was nothing to prevent King from giving it such a right, and by a title which is good as against a trustee in bankruptcy."

The Master failed to see the clear distinction between the *Wood* case and our case, on the one hand, and *In re Great Western Mfg. Co.* case on the other. The former are both cases of valid equitable liens. The latter is a case of a promise to give a real estate mortgage, or equivalent security, at some future time, *when required*, which was neither given nor required until just before bankruptcy.

In the *Great Western* case the parties intended

future security, if required. In our case the parties intended present security on June 30, 1903. It is conceded that our contract was enforceable in equity *inter partes* as a contract for security before October 25th, 1907. *In re Great Western Mfg. Co.* is, like *Page vs. Rogers, 211 U. S., 575, 579*, a case where the parties did not intend present security until just before bankruptcy.

In our case the securities were actually set aside under the agreement of June 30, 1903, they were marked with appellee's name as its property, they were entered on the books of the bankrupt as defendant's property, the bankrupts periodically certified to appellee that

> "*we have specially set aside and hold for your account * * * as security for the drawing credit which you accord us, the following securities.*"

The securities were never removed from the vault when delivered to appellee in 1905 and 1906 and then inspected, checked up and returned. The quantity or value was never depleted and was always in excess of the amount of the drawing credit. The certificates of stock and notes were all properly endorsed at the time they were put into the package. Many of these endorsements were found dated several years back when the securities were examined during the trial. The securities were never used by Kessler & Co. of New York in their business or as a basis of credit. They were always treated as the property of appellee. They were duly entered in the bankrupts' books of account as securities against which money had been borrowed. They never appeared in any report or financial statement made by the bankrupts. None of the bankrupts' creditors knew of their existence, unless possibly some of the purchasers

of drafts who might have been informed that the drafts were secured by the deposit. The securities were kept in the custody of the bankrupts in precisely the same manner and on the same shelf as a large quantity of other securities belonging to customers and other people than the bankrupts. On the faith of this contract and what was done under it the appellees accorded to the bankrupts a drawing credit of £80,000, and during the four and one-half years preceding the bankruptcy accepted about two hundred and fifty drafts. During the ten weeks preceding October 25, 1907, appellee accepted drafts amounting to £80,000, the last of which was accepted by it on the very day it took possession. The proceeds of these drafts were used by the bankrupts in its business. These drafts the appellees have since been required to pay.

Further Reply to Appellant's Brief.

Appellant's present argument is this: that there was no legal pledge prior to possession taken of the scrip on October 25th, 1907; that prior to that time our contract was a nullity against creditors because (1) it was indefinite; (2) there was actual fraud, and (3) the contract was fraudulent in law.

It is conceded that the contract under which the securities were set aside was enforceable in equity, *inter partes.*

This being so, we fail to understand why it is necessary or profitable to characterize the contract. It was enforceable in equity, *inter partes.*—that sufficiently characterizes it as a contract which gave appellees rights over the property set aside which a court of equity will enforce, unless superior rights of general creditors have intervened.

We have attempted to show, under Point I, that the general property in the securities did pass when they were endorsed, put in the package, set

aside and earmarked as our property. Whether that general property passed by way of pledge or mortgage (the property being choses in action) has no bearing upon any question in this case.

The contract being enforceable in equity, *inter partes*, it remains for appellant to show why, how or in what respect the rights of general creditors have intervened, so that the Court will hold that possession taken under this contract was a voidable preference.

Appellant first says that possession so taken was such a preference because the contract was too indefinite. We have already argued the point in this brief at length. Appellant still relies upon *In re Great Western Mfg. Co.* and similar cases of purely executory agreements to give some kind of a lien in the future, if required. Appellant is misled by *Sheridan's* case, which, though briefly reported, was clearly a case of a promise to pledge certain property in the future, and therefore inconsistent with any agreement for present security.

Parshall vs. *Eggert*, *54 N. Y.*, *18*, was a case where the parties intended present security by way of pledge, but failed to give possession to the pledgee, and JOHNSON, *C.*, said:

> "I know of no authority denying the right of a party who has a contract for a pledge, ineffectual for want of delivery, to obtain delivery at a subsequent time, and thus to validate the pledge."

See also *Godwin* vs. *Bank*, *145 N. C.*, *320*, *329–30*.

Appellant then argues under Point III of his brief, that there was actual fraud against creditors in the original transaction.

There is no finding of actual fraud by the District Court and both Judges writing for the Cir-

cuit Court of Appeals below, stated emphatically that the good faith of the parties could not be questioned. As Mr. Justice LURTON recently said in *Merillat* vs. *Hensey, 221 U. S., 333, 341:*

> "In view therefore of the concurrence of both Courts in finding that no actual fraud was intended, we shall pass at once to the question of constructive fraud."
>
> See also *Page* vs. *Rogers, 211 U. S., 575.*

We come then to appellant's main contention, that there was constructive fraud. He rests this contention solely and exclusively upon the doctrine of *Edgell* vs. *Hart, 9 N. Y., 213*, which was reaffirmed in *Skilton* vs. *Codington, 185 N. Y., 80*, and *Zartman* vs. *First National Bank, 189 N. Y., 267.*

DENIO, *J.*, thus stated the doctrine in *Edgell* vs. *Hart, supra*, at *p. 217:*

> "The true question, then, is whether a person engaged in traffic and indebted can make a valid contract or conveyance in favor of one creditor, by which he shall possess a lien upon all the chattels which the debtor shall from time to time have on hand, allowing the latter to sell and purchase like an unqualified owner, the lien attaching only to what may be on hand at the time it is sought to be enforced."

The rule has been strictly confined to mortgages covering their entire stock of merchandise employed by traders in their business.

For a full discussion of this New York doctrine with a review of the cases, see *Jones, Chattel Mortgages, Fifth Edition, § 401 et seq.*

While this Court has stated that it will follow the settled law of each State, it has intimated that

it would not follow this rule if it were an open question, and *Jones, Chattel Mortgages, supra,* at *page 624,* points out that the rule is not supported by any preponderance of authority, that it is contrary to sound policy and that the qualifications made by leading Courts have in a large measure destroyed its force.

We mention this, merely because appellant now asks, not for an application of this rule, but for an *extension* of it to contracts for security upon choses in action. He asks this Court to *infer* that because there is such a rule applicable to such chattel mortgages, the rule as to assignments of choses in action must be similar.

> "In New York the question of fraud in chattel mortgages is materially affected by statute; for although a mortgage be duly filed, it is presumptively fraudulent and void if the mortgagor remain in possession" (citing cases).
>
> *Jones, Chattel Mortgages, supra,* *§ 401.*

We have referred to the New York Statutes on page 25 of this brief, and shown that these statutes do not relate to choses in action.

The New York law as to assignments of choses in action, both legal and equitable, may be found in

> *Niles* vs. *Mathusa, 162 N. Y., 546;*
> *McNeeley* vs. *Welz, 166 N. Y., 124;*
> *Central Trust Co.* vs. *West India Imp. Co., 169 N. Y., 314.*

Niles vs. *Mathusa* is decisive against appellant upon every point, except the point of indefiniteness, which he has argued in his brief.

The debtor assigned a liquor tax certificate as security for a loan. A judgment creditor, with an

unsatisfied execution, attacked the security, claiming (1) that it was a chattel mortgage and void against general creditors because not filed, and (2) that the assignee was estopped because he permitted the certificate to remain in the hands of the assignor, thus clothing him with apparent ownership.

We respectfully refer to the opinion of BARTLETT, *J.*, concurred in by all the Judges sitting, as disposing of appellant's contentions contained at great length in his brief, that appellees were estopped for the same reason, that the contract was fraudulent in fact and fraudulent in law, that rights of creditors have intervened, and particularly of the unsupported assertion that the doctrine of *Edgell* vs. *Hart*, *supra*, reaffirmed in the *Skilton* and *Zartman* cases, can have any application to a legal or equitable assignment of choses in action as security.

McNeeley vs. *Welz*, *supra*, holds that an equitable assignee of a chose in action, has a title superior to a judgment-creditor who has attempted to levy in execution, such property not being subject to such levy.

In *Central Trust Co.* vs. *West India Co.*, *supra*, CULLEN, *J.*, said:

> "It is further the well-settled law of this State, though a different rule prevails not only in England, but in the Federal Courts and in some of the States, that a *bona fide* purchaser for value of a chose in action takes it subject not only to the equities between the parties, but also to latent equities in favor of third persons, and that to secure his superiority it is not necessary that the earlier assignee should give any notice of his assignment to the debtor or trustee."

If, as these cases clearly hold, a general creditor has no standing whatever to question an assign-

ment as security, legal or equitable, secret or otherwise, of a chose in action, how can appellant be be heard to argue that there was actual or constructive fraud upon general creditors, arising out of apparent ownership of these securities by the debtor?

It will be noticed that neither the Master, the learned District Judge, nor the Circuit Court of Appeals gave serious consideration below to appellant's contention that our contract was void against general creditors under the chattel mortgage cases like *Edgell* vs. *Hart*, *supra*.

The Master and the learned District Judge regarded possession taken under the contract as a voidable preference, because they construed the contract to be merely an indefinite promise to give a pledge or mortgage in the future, or when required (*In re Great Western Mfg. Co.*, *supra*), instead of a present contract for security upon property specified, set aside and earmarked.

They apparently regarded the right given to substitute, as in some manner postponing the lien. The parties themselves regarded the transaction as complete, and believed that they had created and intended to create present security upon specified property. The Circuit Court of Appeals, following the New York decisions, has given effect to the intention of the parties (*National Bank of Deposit* vs. *Rogers*, *supra*). The rights of general creditors did not intervene (*American Sugar Refining Co.* vs. *Fancher*, *supra*; *Niles* vs. *Mathusa*, *supra*). In the *Skilton* case and the *Zartman* case, both instances of chattel mortgages covering the entire stock of a merchant, with an agreement permitting him to sport with the property until default, the rights of creditors did intervene in equity, because as to general creditors the mortgages were fraudulent in law.

VI.

There was no reasonable cause for appellees to believe that a preference was intended by the delivery of the securities on October 25th, 1907.

It cannot be that when Alfred Kessler, on October 25, 1907, surrendered these securities on demand to Henry Kessler, with the remark: "All right. They are yours. Do what you like" (*Master's 9th Finding, R., 1015*), he intended to prefer Kessler & Co., Limited, Manchester. He merely intended to carry out the agreement which the Manchester corporation on its part had fully performed. Nor can it be that the Manchester corporation, in demanding and taking what was theirs under their contract, had reasonable cause to believe that a preference was thereby intended, or that anything was intended except to do what was right and proper under the contract. The solvency or insolvency of the New York copartnership was no business or concern of theirs. It was merely acting in recognition of its rights under the agreement. It was not then guilty of securing a voidable preference (see *Humphrey* vs. *Tatman, 198 U. S., 91; Thompson* vs. *Fairbanks, 196 U. S., 516*).

Judge Noyes, writing for the Circuit Court of Appeals below, indicates the serious difficulty in holding such a transaction, in any view of the case, to be a voidable preference (*R.*, 1144).

Moreover, we have contended throughout this litigation, and still insist, that as a matter of law, the proof of insolvency offered by appellant did not meet the clear requirements in such cases.

The foundation proof of insolvency on October 25th, 1911, offered by appellant was (1) the bankrupt copartnership schedules ; (2) the adjudication in bankruptcy.

The other evidence referred to in the opinion of the Master, notably the correspondence between Alfred Kessler and his brother, P. W. Kessler, and the correspondence between Alfred Kessler and his partner, Flinsch, was material and competent only as showing a certain amount of knowledge of the firm's condition possessed by those parties, but not as showing that condition to be insolvent.

The bankrupt's copartnership schedules were insufficient proof of insolvency, because the individual schedules of the partners were not offered.

> *Tumlin* vs. *Bryan*, *165 Fed. Rep.*, *166* [Cited and approved in *In re Pearlhefter*, *177 Fed. Rep.*, *299*, *305; Worrell* vs. *Whitney*, *179 Fed. Rep.*, *1014 ; Francis* vs. *McNeal*, *186 Fed. Rep.*, *481 ; Crancer & Co.* vs. *Wade*, *25 Am. B. R.*, *880* (*Supreme Court of Oklahoma*, *1910*)].

We quote the following from the opinion of the Circuit Court of Appeals for the Fifth Circuit in the *Tumlin* case :

> " As each member of the partnership is liable individually for the partnership debts, it seems to follow that, to show such insolvency as to entitle the trustee to recover, the insolvency of the members of the firm should be proved. If a condition exists whereby all diligent creditors may obtain payment in full, it seems useless and unjust to sustain a suit against a defendant who has only collected what was due to him. It is true that a partnership may be treated as

> an entity, separate from its individual members, for the purpose of its adjudication as a bankrupt (Bankruptcy Act, Sec. 5*a*; *in re Meyer et al., 98 Fed., 976, 39 C. C. A., 368*; *In re Mercur, 122 Fed., 384, 58 C. C. A., 472*); but, in a suit to recover a preference, it is not only the insolvency of an intangible entity, but the insolvency of its responsible component parts that lies at the foundation of the right to relief. If the component parts of the firm may be made to pay the firm's debts, the suit lacks reason and substance, and it cannot be held that the defendant has obtained a greater percentage of his debt than other creditors of the same class. If the members of the firm are solvent, all creditors may be paid in full. If the individual members of the partnership are not shown to be insolvent at the date of the payments, the preference is not voidable (*Vaccaro et al.* vs. *Security Bank of Memphis et al., 103 Fed., 436, 43 C. C. A., 279.* See also *In re Blair et al. (D. C.), 99 Fed., 76*; *Davis et al.* vs. *Stevens et al. (D. C.), 104 Fed., 235*; *In re Forbes et al. (D. C.), 128 Fed., 137*; *In re Perley & Hays (D. C.), 138 Fed., 927*)."

One of the partners, Gillette, was believed by Alfred Kessler to be worth $2,000,000 (*R., 108*) and reputed to have transferred $800,000 to his wife (*R., 534*).

The adjudication in bankruptcy was no proof of insolvency, because the only act of bankruptcy alleged in the petition was the making of a general assignment for the benefit of creditors, on October 30th, 1907.

> *West Company* vs. *Lea, 174 U. S., 590.*

The petition in bankruptcy was not filed until November 8th, 1907.

The books of the firm showed it to be solvent on October 25, 1907, by a margin of $500,000 (*Defts'. Exs MM, R, 979*).

There is no evidence that the assets of the co-partnership as an entity were at a fair valuation on October 25th, 1907, exceeded by the liabilities.

Insolvency as a necessary element of appellant's proof in this suit should not be predicated against the appellees upon inference or upon excited arguments drawn from various letters written by persons describing a New York panic.

Prior to October 25, 1907, the firm of Kessler & Company of New York had never defaulted in a payment nor given the slightest outward sign of weak financial conditions. *All its liabilities up to October 28, 1907, were met as they matured* (*R., 668*). It was one of the oldest and generally regarded as one of the strongest banking houses of Wall street. The ordinary man, knowing the facts that P. W. Kessler and Henry Kessler knew on that day would not have believed them insolvent within the definition of the Bankrupt Act. They might have feared that the New York house would be unable to meet its drafts coming due, and that Manchester would have to take care of them. They might have been apprehensive in this sense. Even a mere suspicion of the insolvency of Kessler & Company was not reasonable cause to believe that Kessler & Company were insolvent on the 25th of October (*Harmon* vs. *Walker, 131 Mich., 540; Stucky* vs. *Bank, 108 U. S., 74; Grant* vs. *Bank, 97 U. S., 80; Off* vs. *Hakes, 142 Fed Rep., 364 (C. C. A., 7th Cir.); Suffel* vs. *The Bank, 127 Wis., 208; in re Pettingill, 135 Fed. Rep., 218, 220; in re Eggert, 102 Fed. Rep., 735* (*C. C. A., 7th Cir*). And how could either P. W. Kessler or Henry Kessler have discovered that Kessler & Company were insolvent if this had been so? The

books did not show it (*Defendants' Ex. MM., R., 979*). Alfred Kessler did not admit it (*R., 248*), and did not know it, if it was the fact (*R., 248*). No one believed it. *It was not the fact.* Insolvency on November 8th, 1907, or even October 30th of that year, is not proof of insolvency on the 25th of October preceding. Indeed, if it had been shown that Kessler & Company were insolvent on the 26th of October, or the afternoon of the 25th of October, it would not follow that they were insolvent when physical possession of the collateral was taken by Kessler & Company, Limited, on the morning of that day because of the rapid decline in the security market at that time (*Upson* vs. *Mount Morris Bank, 103 App. Div., N. Y., 367*.

There was some proof of the value of securities held by the firm, and we offered proof of the value of the "escrow," but all of this proof, beside being wholly inadequate to establish insolvency was based upon changed values caused by the failure on October 30th, 1907, of the firm itself (*R., 865, 866*). Most of these securities were participations in syndicates of which the New York firm was the manager, and naturally the failure of that firm greatly diminished their value.

The Manchester corporation accepted a draft for £5,000 drawn by the New York copartnership on the very day, October 25, 1907, when the scrip was taken over (*Defendants' Ex. DD., R., 955*). The fact that the Manchester house went on accepting drafts right up to the time of the failure, and actually increased the drawing credit by £20,000 on August 27, 1907, is utterly inconsistent with a belief by the Manchester corporation that the New York firm was insolvent or that a preference was intended.

We assume that the Court will not disturb the findings of the Courts below as to any *primary* facts

(*Merillat* vs. *Hensey*, *221 U. S.*, *333*). The *primary* facts in this case are not disputed, but the *inferences* and *deductions* therefrom as to insolvency as a necessary element to entitle complainant to recover in this suit, and reasonable cause to believe a preference was intended should be closely scrutinized by this Court and, if such deductions are not warranted there is another reason why the decree of the Circuit Court of Appeals should be affirmed.

VII.

The decree of the Circuit Court of Appeals should be affirmed and the complaint dismissed upon the merits.

McLaughlin, Russell, Coe & Sprague,
Solicitors for the Defendants-Appellees,
Number 165 Broadway,
Manhattan, New York City.

Abram I. Elkus,
Frederick C. McLaughlin,
Rufus W. Sprague, Jr.,
Of Counsel.

December, 1911.

INDEX.

PAGE.

POINTS.

I.

PAGE.

POOR COPY